

STATE OF CALIFORNIA

SENATE SELECT COMMITTEE TO INVESTIGATE
PRICE MANIPULATION OF THE WHOLESALE ENERGY MARKET

OVERVIEW OF INVESTIGATIONS, STUDIES, AND
REPORTS REGARDING THE ENERGY CRISIS

IRVINE CITY COUNCIL CHAMBERS
ONE CIVIC CENTER PLAZA
IRVINE, CALIFORNIA

FRIDAY, MAY 18, 2001

9:20 A.M.

Reported by:

Evelyn J. Mizak
Shorthand Reporter

APPEARANCES

MEMBERS PRESENT

SENATOR JOSEPH DUNN, Chair

SENATOR DEBRA BOWEN

SENATOR MARTHA ESCUTIA

SENATOR SHEILA KUEHL

SENATOR WILLIAM MORROW

MEMBERS ABSENT

SENATOR WES CHESBRO

SENATOR MAURICE JOHANNESSEN

SENATOR BYRON SHER

STAFF PRESENT

ALEXANDRA MONTGOMERY, Committee Consultant

LARRY DRIVON, Committee Counsel

DONNA DRIVON, Committee Technology Assistant

L. ERIK LANGE, Deputy Legislative Counsel
Office of Legislative Counsel

ALSO PRESENT

LARRY AGRAM, Mayor
City of Irvine

ELAINE HOWLE, State Auditor
Bureau of State Audits
California State Auditor

DOUG CORDINER, Audit Principal
Bureau of State Audits

SHARON REILLY, Chief Legal Counsel
Bureau of State Audits

ROBERT PEASE, Managing Attorney
Market Oversight and Enforcement Section
Office of General Counsel
Federal Energy Regulatory Commission

LORETTA LYNCH, President
California Public Utilities Commission

INDEX

	<u>Page</u>
Proceedings	1
Opening Statements by CHAIRMAN DUNN	1
Welcoming Statement by LARRY AGRAM, Mayor City of Irvine	1
Introduction of Staff	2
Synopsis of Past Hearings	4
Update of Current Select Committee Activities	6
Testimony of ELAINE HOWLE, State Auditor	8
Questions by CHAIRMAN DUNN re:	
Personal Employment History and General Description of State Auditor	9
Jurisdiction of Office	10
Audit Boundaries	11
Letter by SENATOR STEVE PEACE Requesting Audit	12
Description of ISO, PX, and IOUs	12
Scope of Audit into Activities and Operations of ISO and PX	13
Market Surveillance Groups	14
Questions by SENATOR BOWEN re:	
Ability of Market Surveillance Groups to Take Unilateral Action to Correct Problems	14
FERC's Market Surveillance Mechanisms	15
Questions by CHAIRMAN DUNN re:	
March Audit Report	15

Practical Outcome for Consumers When More Power Was Purchased by ISO Rather Than PX	16
Underscheduling Comparisons in '99-'2000.....	17
Strategic Bidding in PX Market	17
Questions by SENATOR BOWEN re:	
Would Such Strategic Bidding Happen in Competitive Market.....	18
Statutory Requirement of ISO to Procure Electricity	19
Question by CHAIRMAN DUNN re:	
Properly Functioning Competitive Market.....	20
Questions by SENATOR BOWEN re:	
Supply Availability.....	20
Resumption of Testimony re:	
Western Grid Region.....	20
Out-of-Market Purchases	21
Questions by CHAIRMAN DUNN re:	
Price Caps	21
Out-of-Market Purchases Not Covered by Price Caps	22
Out-of-Market Sellers Vs. ISO Market Participants.....	22
Questions by SENATOR BOWEN re:	
Trading Corporations Selling to Each Other to Avoid Price Caps	23

Questions by SENATOR ESCUTIA re:

Experience with Same Activity Occurring at Any Other Time.....	24
Reaction of Sequential Market Scenario In '97 and '98.....	24

Questions by SENATOR BOWEN re:

Physically Sufficient Power Supply	25
--	----

Resumption of Testimony re:

Chart Showing Underscheduling	25
-------------------------------------	----

Questions by CHAIRMAN DUNN re:

Benefit of Underscheduling to Sellers.....	26
Underscheduling Requires ISO to Make Out-of-Market Purchases	27

Questions by SENATOR BOWEN re:

The Buyers of Electricity	27
Sellers' Ability to Anticipate Needs of Buyers on Any Given Day.....	27
Explanation of "Strategic Bidding"	28
Economics When Supply and Demand Cross.....	28
Markets with Cost-Based Rates	29

Questions by CHAIRMAN DUNN re:

Low or No Risk to Sellers Who Knew Availability of Collective Megawatt Capacity on Given Day.....	30
---	----

Resumption of Testimony re:

Chart Showing Effect of Price Cap in ISO Market Affecting PX Market	30
--	----

Questions by CHAIRMAN DUNN re:

More Strategic Bidding Beginning in Year 2000	31
No Consequence for Strategic Bidding	31

Resumption of Testimony re:

Chart Relating to Market Surveillance Groups	32
Monitoring Groups Starting to See Problems in August, 1998	32
Few Actions Taken by PUC and FERC In Response to Concerns of Market Monitoring Groups	33
Chart Showing PUC's Response to Market Monitoring Groups' Concerns	33
FERC's Lack of Response	34

Questions by CHAIRMAN DUNN re:

Definition of "Exercise of Market Power"	35
--	----

Questions by SENATOR BOWEN re:

Increase in Demand Not Commensurate with Increase in Prices	36
--	----

Questions by CHAIRMAN DUNN re:

Department of Justice's Definition of "Market Power"	37
Confidentiality Requirements under Which State Auditor Must Operate	37
Confidentiality Objections Encountered	39
Which Market Participants Objected on Confidentiality Grounds	40
Inability of State Auditor to Share Confidential Information	42

Questions by SENATOR BOWEN re:

Inability of Public Entities to Get Timely Information to Ensure Accountability.....	43
--	----

Questions by SENATOR ESCUTIA re:

Grounds for Confidentiality Claims	44
Response by SHARON REILLY, Counsel State Auditor.....	45
FERC Tariff with ISO	46

Questions by SENATOR BOWEN re:

Information on Buying Patterns Is Public, Yet Information on Selling Information Is Deemed Confidential	47
---	----

Questions by CHAIRMAN DUNN re:

Audit Included Market Surveillance Activity of ISO and PX	47
Problems, Deficiencies or Criticisms with Methodology Used by Market Surveillance Entities within ISO and PX	48
"Voodoo Economics"	48
Handout of Independent Energy Producers at Prior Hearing.....	49
Auditor's Purported Exoneration of Market Participants.....	50
Finding in Report that Exercise of Market Power Contributed to Higher Prices	50
Scope of Next Auditor's Report	51
Purpose of California Energy Commission.....	52

Questions by SENATOR MORROW re:

FERC's Determination of Insufficient Evidence of Abuse of Market Power	53
Opinion on FERC's Statement to Western Governors' Association that FERC Would Not Pursue Generator Repayments to Purchasers Due to Impossibility of Task.....	53
What Could Be Done to Conduct More Thorough Investigation into Abuse of Market Power.....	54

Questions by CHAIRMAN DUNN re:

Auditor's Permanent Staff's Lack of Detailed Knowledge about Energy Market	55
Process of Hiring Outside Consultants.....	56
Difficulty Finding Knowledgeable Consults with No Conflicts of Interest.....	57
Identification of Three Consultants Hired for This Audit Report	58
Resolution of Any Conflicts of Interest Concerns with Hired Consultants	58
Charles Cicchitti of Pacific Economics Group	61
Cicchitti Affidavit Filed with FERC	62
Market Participants Who Had Concerns With Retention of Cicchitti by Auditor.....	63
Involvement of Cicchitti in Auditor's Report	64
Challenge of Hiring Consultants with No Conflict of Interest in This Area	65

Questions by SENATOR BOWEN re:

Problems with Cicchitti	65
Inability of Cicchitti to Independently Examine ISO's Market Surveillance Mechanisms	66

Questions by SENATOR MORROW re:

Any Demonstration of Bias Toward Duke Power by Mr. Cicchitti	68
---	----

Questions by CHAIRMAN DUNN re:

No Concerns with Methodology or Conclusions of Market Surveillance Entities in ISO and PX	70
Agreement with Conclusion of Market Surveillance Entities that Market Power Has Been Exercised	70
Competition Has Actually Increased Prices	71
Completeness of Audit	71
Any Criticism of Findings	71
Identified Causes of Energy Crisis	72
Graph Identifying Concerns Raised by Several Entities	74

Testimony of ROBERT PEASE, Managing Attorney Market Oversight and Enforcement Section, Office of General Counsel, FERC	75
--	----

Questions by CHAIRMAN DUNN re:

Personal and Professional History, Involvement at FERC, Role of FERC and Jurisdictional Boundaries	76
Confidentiality Provisions that Emanate from FERC Tariffs	77

Information Filed with ISO Vs. FERC	78
Confidential Data Provided to FERC But May Not Be Provided to ISO	79
FERC's Six-Month Rule regarding Confidential Data.....	80
Reason for Six-Month Rule	81

Questions by SENATOR BOWEN re:

Balance between Confidentiality Protections and FERC's Mandate to Protect Consumers.....	82
\$1900 per Megawatt Hour as Just and Reasonable Price.....	84

Questions by SENATOR ESCUTIA re:

Six-Month Confidentiality Provisions in Tariffs between FERC and ISO	85
Type of Confidential Information and Procedure for Requesting Information	85
Freedom of Information Act Requests	87
Claims of Confidentiality that Might Be Triggered through FOIA Request	88
Time Deadlines for FOIA Requests and Responses	88
FERC's Regulations on Confidentiality.....	89

Questions by SENATOR BOWEN re:

After Six Months, Confidentiality Governed by FOIA rather than FERC	91
--	----

Questions by CHAIRMAN DUNN re:

Application of Confidentiality Provisions With Respect to Other Categories	91
---	----

Any Objections from Market Participants to Data Being Turned over from ISO to FERC.....	92
Definition of "Bid Data"	93
Possibility of Requesting FERC to Define Bid Data and Various Provisions.....	94
Provisions that Might Preclude Production of Staff Reports	95
Ability to Request Information Under FOIA	96
Questions by SENATOR BOWEN re:	
Statutory Basis for FERC Tariffs that Provide for Confidentiality	96
Luncheon Recess	97
Afternoon Proceedings	98
Resumption of Testimony of ROBERT PEASE with FERC.....	99
FERC's Issuance of Two Orders in March, 2001	99
Refund Order to Mitigate High Prices in January and February	99
AES Southland and Williams Energy Marketing and Trading Ordered to Justify Duration of Outages at Plants in Alamitos and Huntington Beach	100
Current El Paso Case Currently Before Administrative Law Judge	100
FERC's April 26 th Adoption of New Market Monitoring and Mitigation Plan for California	101
Stage One Threshold for Price Mitigation.....	101

FERC's Announcement to Expedite Certification Process for Natural Gas Pipeline Capacity into West	102
Need for Infrastructure Improvements	102
Need to Expand Intrastate Pipeline System	103
Increase in FERC Staffing of Market Oversight and Enforcement Section	103
Staff Investigating All California Outages to Determine Possible Withholding Of Power	103
Staff Examining Bid Data to Determine if Generators Are Exercising Market Power by Economic Withholding, and to Determine Patterns of Manipulation or Collusion.....	103
Investigation of Natural Gas Transactions....	104
Audits of Certain Generators Operating in California, Monitoring Transactions Between Shippers and Generators, and Analyzing Prices of Commodity and Transportation Paid by Shippers and Marketers in California.....	104
Capacity of Interstate Pipelines and Intrastate Pipelines	104
Questions by CHAIRMAN DUNN re:	
FERC's Definition of "Market Power"	105
Market Participants Must Prove Lack of Market Power to Operate on Market-Based Rate Authority.....	105
Possibility of FERC Determination, Retroactively, that Market Participant Had Market Power.....	106
FERC's Authority to Go Back Retroactively And Make Redress.....	106

Questions by SENATOR BOWEN re:

Statutory Authority for FERC to Grant Market-Based Rate Authority	108
Establishment by FERC of Regulations or Standards for Granting Market-Based Rate Authority.....	109
Hub-and-Spoke Analysis	109
Any Standard by Which Revocation of Market-Based Rate Authority Would Occur.....	110

Questions by CHAIRMAN DUNN re:

Cost-Based Vs. Market-Based Rates	110
---	-----

Questions by SENATOR BOWEN re:

Has Commission Ever Revoked Market- Based Rate Authority.....	111
Time Period of Rate Authority	111
Evidence or Standards FERC Might Use to Grant Renewals of Market-Based Rates	112
Burden on FERC in Renewals	113
FERC's Mitigation Proposal	114
Enforcement Mechanism.....	115
Statutory Basis for FERC to Order State to Make Voluntary Regional Transmission Organization Filing as Condition of Enforcement of Federal Power Act	116

Questions by SENATOR ESCUTIA re:

Regulations to Control Prices if RTO Is Not Filed.....	118
Rehearing Request Time Deadline	118

Questions by SENATOR MORROW re:

Would FERC's Finding of Unjust and Unreasonable Equate with Violation of Federal Power Act	119
Would Find of Violation of Rate-Based Authority Equate with Violation Of Federal Power Act	120
FERC Must Find Violation of Federal Power Act to Order Across-the-Board Refunds	120

Questions by SENATOR BOWEN re:

How Finding of Unjust and Unreasonable May Not Be Violation of Act	121
Difference between Unjust and Unreasonable Rates and Violation of Act	123

Questions by CHAIRMAN DUNN re:

Purpose of Generic Decision by FERC that Rates Were Unjust and Unreasonable.....	123
Generic Conclusion Vs. Conclusion Regarding Individual Market Participants.....	124

Questions by SENATOR MORROW re:

FERC's Investigation of Individual Market Participants.....	126
Time Period of Investigation	126
Would Withholding or Underscheduling of Supply Be Violation of Rules	127
Confidential Information Provided to FERC Vs. ISO.....	127
Joskow-Kahn Report.....	128
Ability of FERC to Share Information	129

Questions by SENATOR KUEHL re:

Earliest Point in Time When FERC Determines Prices Were Unjust and Unreasonable.....	131
Evidence Used by FERC to Determine Noncompetitive Market.....	131
Claims that FERC Only Looks at California Market During Stage Three Emergencies	133

Questions by SENATOR ESCUTIA re:

Documents that Prove or Disprove Market Conduct.....	135
Confidentiality of All Documents	136
Request that Committee Make FOIA Request for FERC Documents	138

Questions by CHAIRMAN DUNN re:

FERC Will Refuse to Disclose What Documents They Possess	139
Committee Ought to Follow FOIA Request Standards.....	140

Questions by SENATOR MORROW re:

Auditor's Report of FERC's Announcement to Western Governor's Association to Not Pursue Individual Generator Payments	141
---	-----

Questions by SENATOR BOWEN re:

Difference between FOIA Request and Information Provided to State and Regional Authorities	143
<u>New York Times</u> Assertion that FERC Staff Did not Enforce Requirement that Power Companies File Detailed Quarterly Sales Reports	144

Testimony of LORETTA LYNCH, President California Public Utilities Commission	144
---	-----

Questions by CHAIRMAN DUNN re:

Personal Background and Involvement With PUC, Description of PUC and Its Jurisdiction.....	145
Authority of Market Participants in Wholesale Market.....	145

Questions by SENATOR BOWEN re:

Are Blackouts Health and Safety Issue.....	146
--	-----

Questions by CHAIRMAN DUNN re:

PUC's Confidentiality Provisions	146
Need for PUC to Collect Information from ISO	147
Initiation of PUC Request for Bidding Data from ISO.....	148
PUC Investigations into Wholesale Electricity Market Prior to June 14, 2000 Blackout in San Francisco	149
May 22, 2000 Price Spike Incident	149
Actions and Conclusions of PUC Following June 14, 2000 Blackout	151
Conclusion in Kahn-Lynch Report of Market Dysfunction.....	152
Data Examined to Reach Conclusion	153
Data Not Accessible for Report, and Ability to Gain Access to Price Data	154

Questions by SENATOR MORROW re:

Any Requests to FERC for Data	155
-------------------------------------	-----

Questions by CHAIRMAN DUNN re:

Sources of Information other than Subpoenas to EOB and ISO	155
Information Lynch and Kahn Were Unable to Obtain.....	156
Efforts of PUC in Examining Wholesale Electricity Market.....	156
List of Market Participants that Received Subpoenas from PUC	157
Definition of "Scheduling Coordinator".....	158
Response to Subpoenas by Market Participants, ISO and PX.....	158
PUC's November 4, 2000 Motion to FERC to Compel Production of PUC- Subpoenaed Documents	159
Lack of Response from FERC	160
Confidentiality Arguments	161
Ruling on December 20 th to Deny Motions of Generators for Further Modification of Protective Order and Instructing Compliance With Subpoena Requests	162
Subpoenas to ISO and PX.....	162
PUC Inspection of Plants Experiencing Forced Outages.....	163

Questions by SENATOR BOWEN re:

Definition of "Forced Outage"	164
Plants Not Required to Report Reasons For Forced Outages.....	165

Questions by CHAIRMAN DUNN re:

Lack of Cooperation during Plant Visits.....	166
--	-----

Lack of ISO Notification	166
Resistance of Generators to PUC's Plant Inspections	167
Difficulty Determining Legitimacy of Unplanned Outages	167
Basis for Generators' Demand of Advanced Notice of Visits by PUC	168
Response of ISO to Original PUC Subpoena for Documents	169
ISO Board Participants Pre and Post January 2000	171
Status of PX in January 2000	171
Reason for PX Shutting Down	172
Steps Taken, Other than Issuance of Subpoenas, to Investigate Wholesale Electricity Market in California	172
Other Investigative Steps Underway or Anticipated by PUC	173
Current Status of Document Requests	174
Conclusions of PUC Investigation	174
Findings of Physical Withholding	175
Quote of Charles Oglesby	178
Confidentiality Requirements Preclude Identifying Type of Data, as Opposed to Content of Data	180
PUC Graphs of Output from Generating Unit on November 14, 2000	180
Slide of November 15, 2000 Showing Unit Increasing Output after Stage One, Then Dropping Output, and Increasing Again Just Before Stage Two Alert	182

Slide Showing November 14, 2000 Unit Which Increased and Decreased Capacity Parallel to Spot Market Price	182
Definition of RMR, Reliability Must-Run.....	182
Conclusion Reached regarding Generating Output of Units.....	183
Comparison of Unit Outputs Prior to November, 2000.....	184
Confidentiality of Market Price Information	184
Collection of Data on Production Levels of Generation Units	185
Other Overlays Which Could Be Used in Conjunction with Slides	186
PUC's Investigation of Maintenance and Operation Logs of Generation Units	187
PUC's Examination of Generation Units Prior to November, 2000	187
Availability of Information Used in Prior Examinations.....	188
Inability of PUC to Identify Generator Shown in Slides Due to Confidentiality Provisions	188
Consultants and Experts Hired by PUC to do Investigation.....	189
Conclusions Thus Far regarding Existence of Potential for Market Power Or Exercise of Market Power	190
Any Further PUC Investigation with Respect to Market Power.....	192
PUC's Definition of Market Power	192

Has PUC's Investigation Explored Market Power Exercised in Collusive Fashion	193
PUC's November 22 Report of Open Communication Inappropriate in Competitive Market.....	193
Market Participants' Access to Real- Time Market Data.....	195
WSCC's Information to Real-Time Market Data	197
Bidding Strategies of Market Participants Before and After Access to Real-Time Market Data	198
Additional Progress with Respect to Summer of 2000.....	200
Contemplated Additional Activity to Complete Investigation.....	200
Analysis of Metered Energy Flows	201
Megawatt Laundering.....	202
Where Power is Coming from to Maintain Same Level of Imports.....	203
Natural Gas Complaints Filed by PUC	204

Questions by SENATOR BOWEN re:

Rate Increases that Might Be Seen This Summer if PG&E and Edison Customers Were in Same Situation as SDG&E Last Year....	205
Can Rates, under Any Scenario, Be Called Just and Reasonable	206
Percentage of Price Increase in Natural Gas Market This Winter	207
FERC Mandated to Ensure Just and Reasonable Rates.....	208

Questions by CHAIRMAN DUNN re:

Anything in Near Future to Impact Wholesale Market in California	209
Any Confidence in FERC Action	209
Inability of FERC to Enforce Federal Power Act's Mandates	210
Resumption of Testimony of ROBERT PEASE, FERC ..	211

Questions by CHAIRMAN DUNN re:

Assertion that Only FERC Has Cost-Based Data.....	211
Importance of Cost-Based Data to FERC's Investigations.....	212
FERC's Access to Generator-Specific Information Vs. ISO	213
Marginal Cost or Proxy Price	213
Exclusion of Scarcity Rents and Opportunity Costs.....	214

Questions by SENATOR BOWEN re:

FERC's Most Recent Order Only Refers to Generators with PGAs	215
Order Doesn't Apply to Many Marketers and Traders	215
Loophole in FERC's Order for Marketers and Traders	216

Questions by CHAIRMAN DUNN re:

Can Loophole Be Fixed.....	218
----------------------------	-----

Questions by SENATOR BOWEN re:

High Number of Forced Outages in Workably Competitive Market	219
---	-----

Differences between FERC and PUC in Terms of Forced Outages	219
Three to Four Times As Many Outages Currently than One Year Prior	220
Reduction in Amount of Hydro Power	221
No Incentive to Withhold Generation under Cost-Based Rates.....	223
Mandate to FERC to Deal with Unjust and Unreasonable Rates at All Times	224
Legal Authority of FERC to Continue A Tariff that Does Not Result in Just and Reasonable Rates.....	225
Implied Finding on FERC's Part	225
Legal Authority for FERC's Order that Only Addresses Some Periods When Unjust and Unreasonable Rates Were Found to Exist.....	226

Questions by CHAIRMAN DUNN re:

FERC Currently Looking into Possibility of Coordinated or Collusive Behavior	227
Subpoenas Issues regarding Coordinated or Collusive Behavior.....	227
One Investigation Vs. Multitude of Investigations.....	228
Size of FERC.....	228
California Investigations by FERC Conducted Out of Washington, D.C.	229
Publicly Available Information with Respect to Consultants Retained by FERC for Investigation of California Wholesale Electricity Market.....	229
Any Anticipated New FERC Reports	229

Publication Distributed by Independent
Energy Producers..... 230

Has FERC Issued Clean Bill of Health
Governing Generators and Their Behavior
On California Wholesale Electricity Market... 231

FERC's Criticism of Methodology or
Conclusions Reached in Reports Issued
By Marketing Surveillance Entities of
California ISO and PX..... 231

FERC's Suggestion to Narrow Time
Periods in Sheffrin's Report 233

Personal Dealings with Frank Wolak,
Eric Hildebrandt and Anjali Sheffrin 235

No Reason to Question Market Surveillance
Group's Professionalism, Experience,
Methodology, Integrity, or Motivation..... 235

Questions by SENATOR BOWEN re:

Is FERC Seeking Ways to Better Monitor the
California Market..... 236

Need for Shorter Enforcement Period 237

Questions by CHAIRMAN DUNN re:

Possession of Energy Output Information
For Each California Generator from
'90-'98 237

Conclusion that California Does Not Have
Substantially Competitive Wholesale
Electricity Market..... 238

Undercuts Premise Allowing Generators
Access to Market-Based Rates 238

Approval of Renewal Applications for
Market-Based Rate Authority 239

Questions by SENATOR BOWEN re:

Renewal of Application Described as Akin to Renewal of Driver's License	240
--	-----

Questions by CHAIRMAN DUNN re:

Actual Vs. Potential to Exercise Market Power.....	242
Which Applications for Renewal Have Been Filed with FERC	242
FERC's Own Description of Market Power Is Uncertain.....	243
Agreement to DOJ's Definition of Market Power.....	243
Termination of Proceedings	244
Certificate of Reporter	245

1 P-R-O-C-E-E-D-I-N-G-S

2 -- oo0oo--

3 CHAIRMAN DUNN: Good morning, everybody. I think
4 it's about that time for us to commence in our third hearing of
5 the Senate Select Committee to Investigate Potential
6 Manipulation in the Wholesale Electricity Market.

7 Before I make any comment, I want to turn it over
8 to the Mayor of this gracious City of Irvine that has allowed us
9 to use their beautiful facilities. In fact, I think we'll trade
10 in some of our hearing rooms in Sacramento for this room, if we
11 could. Let me turn it over for some welcoming comments to the
12 Honorable Mayor of Irvine, Larry Agram.

13 MAYOR AGRAM: Thank you, Joe. I really
14 appreciate your kind remarks about our city.

15 We are delighted to welcome you here to the City
16 of Irvine, to these Council Chambers, where matters large as
17 small have been discussed over many, many years now.

18 This morning, of course, you're taking on a very
19 important issue.

20 I want to also extend a personal warm welcome
21 you, and acknowledge the wonderful leadership that you have
22 provided for our county in Sacramento. You're the Senator from
23 a neighboring district. You are a good neighbor and friend, and
24 a good friend of consumers throughout the state. And I know
25 that in the long run, that's what your work is about, defending
26 the interests of consumers, as we try to do the same here
27 locally.

28 So, welcome. I'm going to have to leave in a

1 moment and head upstairs. Please, once you have solved the
2 energy crisis, send word up to the third floor. I'll be there

3 today.

4 CHAIRMAN DUNN: We can celebrate. Thank you very
5 much, Mayor.

6 I need to do a few of my own acknowledgements
7 here beyond the City of Irvine and their gracious hospitality.

8 First of all, we do have with us from Sacramento
9 several of our Sergeant-at-arms to ensure an orderly process
10 today. We have Sergeant-at-arms Carlstad, Johnson, and Taylor,
11 who are spread around the room here. There they are, and one in
12 the back. If you are in need of anything -- no, that doesn't
13 include water and coffee, et cetera -- please feel free to ask
14 each of them as well. I thank them for making the trip and
15 providing their services today.

16 Also, for those who have been to our hearings
17 before, you will know that they are all transcribed by a court
18 reporter. We have our usual and faithful court reporter,
19 despite the rather hellacious pace we have put her through in
20 past hearings, and that's Evelyn, who is down here in the front
21 as well.

22 To make sure that she doesn't go completely
23 stir-crazy, we'll take a break about every hour-and-a-half or so
24 for not necessarily our sake, but for Evelyn and the sake of the
25 endurance of her fingers as she practices her profession. So,
26 you can count on a break about every hour-and-a-half or so as
27 well.

28 I also want to alert everybody who is here for

1 the duration today that we are going to take a lunch break.
2 It's going to be about an hour-and-a-half long. The reason for
3 that lunch break is, one of our key witnesses today is the
4 President of the California PUC, Loretta Lynch, who has a
5 speaking engagement here in the City of Irvine, as do I at the

6 same engagement as well. So, many of us are going to be going
7 to that. It's a lunch sponsored by the OCBC and the Orange
8 County Public Affairs Association. So, we will be away for
9 about an hour-and-a-half, from about noon to 1:30.

10 I can't give a prediction of exactly how long
11 we'll go today. It depends upon the testimony. We have slotted
12 the whole day, right up until 5:00 clock. I suspect we will not
13 go that long today, but every time I say that, I am proven
14 wrong, and Evelyn is looking at me with a suspicious eye over
15 here, since we dragged her well into the evening on the first
16 hearing.

17 But that's probably the best I can give you as
18 far as our schedule is concerned today.

19 There are some administrative matters that I need
20 to go into, and an update regarding the status of our work on a
21 day-to-day basis.

22 Before I do that, I certainly would invite
23 Senator Debra Bowen, who is sitting up here to my right, who is
24 from the Long Beach and other surrounding areas in the County of
25 Los Angeles, is here as well. Senator Bowen, any opening
26 comments you'd like to make? No.

27 We will also be joined as the morning progresses
28 with other of the Senators that serve on this committee. We

1 expect to be visited by Senator Martha Escutia, Senator Sheila
2 Kuehl, and also Senator Bill Morrow will be joining us at one
3 point or another throughout the morning and into the afternoon.

4 Some have asked why here in Southern California.
5 When we started this investigation, we said that we would try to
6 have the hearings not just based in Sacramento. So, this is the
7 first of what ultimately may be a few more in Southern
8 California of these hearings as we progress through in the

9 coming weeks, and potentially coming months as well, as we
10 investigate into that wholesale electricity market. So, that's
11 what brings us here to Southern California this week.

12 What have we done so far with respect to
13 hearings? For those who have not been at our previous hearings,
14 or listened into our previous hearings, we have had two other
15 hearings, both of them in Sacramento. We had several different
16 witnesses that appeared, primarily from the Market Surveillance
17 Committee and the Market Analysis Committee of the ISO, who
18 shared the fruits of their analysis of the wholesale electricity
19 market.

20 If I can summarize it quickly without going
21 witness by witness, basically what we heard is that in their
22 view, there is an exercise of market power in the wholesale
23 electricity market. Market power being defined as the ability
24 to affect prices without competitive consequences. It's an
25 economic term that economists who keep an eye on markets are
26 always on the watch for.

27 And we also talked about whether that market
28 power that they had was also exercised in a collusive manner.

1 Those witnesses did not provide any evidence of collusion, and
2 that, they felt, was beyond their scope. That is one of the
3 issues we'll be looking at in future hearings.

4 What brings us here today as far as the witnesses
5 is that there have been a number of investigations that have
6 been ongoing, cited by all kinds of individuals on all sides of
7 this issue. The State Auditor, Elaine Howle, who'll be our
8 first witness, was one of the investigations that have been
9 cited, and so we want to hear about that investigation and the
10 scope of that investigation.

11 The same applies to our second witness, which

12 will be the President of the California PUC, Loretta Lynch. And
13 then also we have Bob Pease, one of the attorneys with the
14 Federal Energy Regulatory Commission.

15 Senator Bowen just whispered, he's not to be
16 confused with Senator Steve Peace from the San Diego area. No
17 relation, different spelling, in fact.

18 But Mr. Pease will be our final witness today. I
19 think we actually may have one other one. I'm sorry, we are
20 also going to have a U.C.I. Professor by the name of Peter
21 Navarro, representing the consumer view of this issue, that will
22 testify at the end of the day.

23 I want to just make a few comments, and then
24 we'll finally get into the testimony, as Elaine has been
25 patiently waiting through actually the two other hearings and
26 now our third.

27 For those that have been watching our work
28 closely, I want to give you a quick update. We expect to be

1 produced today from the ISO all of their bidding data that is
2 confidential. This is pursuant to a subpoena that this
3 committee issued two weeks ago, about two weeks ago. We've been
4 in rather intense discussions, negotiations, outright arguments
5 with many of the market participants who have raised concerns
6 about the production by the ISO to our committee of the
7 confidential bidding data information, as well as other
8 information. But we expect that that material will be produced
9 to us. In fact, the hour being 9:30, it may have all ready been
10 produced in Sacramento to us.

11 We have agreed to abide by the same
12 confidentiality terms that apply to the ISO for purpose of that
13 production. We know that many of the market participants do not
14 believe that is sufficient from their perspective, and we expect

3ENERGY.TXT

15 to continue that argument, discussion, negotiation, however we
16 want to construe it, in the coming days and weeks.

17 In addition, we have issued a subsequent subpoena
18 to the PX for all of their documents concerning the market data,
19 bidding data, et cetera. And we expect the production from the
20 PX in relatively short order as well.

21 We continue in our discussions with the market
22 participants, particularly what I refer to as the Big Five
23 generators, concerning the document requests that were served
24 upon them over a month ago now. We have met on several
25 occasions, many telephone conversations, face-to-face
26 discussions, regarding their confidentiality concerns. We have
27 not resolved those concerns as of this point in time. We
28 anticipate that we will be soon issuing subpoenas as a follow-up

1 to those document requests.

2 We also issued document requests to Enron, one of
3 the market participants that is not a generator, but what is
4 often described as a pure trader, and there are more document
5 requests going out to other market participants that fall into
6 the same category.

7 We've also issued a document request to Morgan
8 Stanley for all information that they have relating to
9 prospectus that they prepared for some of the sales of the
10 California generation assets by the California IOUs to various
11 generators, et cetera, over the course of '97 to early 1999. As
12 of yet, I don't believe we've had an official response from
13 Morgan Stanley. That request just went out a few days ago, but
14 that -- am I missing any of our requests, Alex or Larry? No.

15 For those of you wondering, sitting to my right
16 is Larry Drivon. He is Special Counsel to the Senate
17 Investigation Committee. Sitting to my left is Alexandra

18 Montgomery, who is on my staff at the Capital, who's dedicated
19 200 percent of her time to this investigation. She's just
20 trying to find where she gets the hundred percent above the
21 initial hundred percent.

22 And finally, just to alert everybody, we expect
23 the pace to pick up quickly concerning our hearings and the
24 investigation. All of the hearings thus far, including today,
25 have been and will be today foundational, just laying
26 foundations about what other investigations have done or not
27 done, and building upon them from this point forward. So, we
28 expect to pick up the pace and begin a more thorough examination

1 of the behavior of individual market participants in the coming
2 hearings.

3 I guess the best way to put that, for those who
4 are interested in kind of the flashy stuff, that's coming in the
5 coming hearings, and this is more the foundational things so we
6 don't repeat work that's been done by various investigations
7 thus far.

8 And again, Senator Bowen, any comments? None
9 whatsoever.

10 Enough with the preliminary comments. Let's move
11 forward with our first witness, which is the State Auditor.
12 Let's start by turning to Erik, if you would swear in the
13 witness, please.

14 MR. LANGE: My name is Erik Lange with the Office
15 of Legislative Counsel.

16 I would like to ask the witness to please stand,
17 raise your right hand and state your name for the record,
18 please.

19 MS. HOWLE: Elaine Howle.

20 MR. LANGE: Thank you.

21 [Thereuopon the witness,
22 ELAINE HOWLE, swore to tell
23 the truth, the whole truth,
24 and nothing but the truth.]

25 MR. LANGE: Thank you. You may be seated.

26 CHAIRMAN DUNN: Ms. Howle, what I'd like to do is
27 just first ask you some basic background questions. I know you
28 also have some comments that you are prepared to give as well

1 concerning your audit, the audit that has already been issued.

2 But for the sake of everyone who is here, and for
3 completeness of the record, can you give us a little background
4 about yourself, your history at the State Auditor's Office, and
5 also a general description of what the State Auditor is?

6 MS. HOWLE: Certainly.

7 I've been with the State Auditor's Office since
8 1983. I was recently appointed as the new State Auditor in
9 August of last year.

10 The State Auditor's Office is an independent,
11 nonpartisan office in the State of California. And basically,
12 we get our work through the Joint Legislative Audit Committee,
13 which is a committee of both Assembly Members and Senators,
14 seven Members from each House. Our work is generated by
15 Members of the Legislature, so a Member of the Legislature can
16 submit a request to that committee. The Chairman this year is
17 Mr. Keeley, Assembly Member Keeley.

18 After a Member submits that request, we put an
19 analysis together, and then there is a committee hearing, and
20 the committee will hear the particular requester's request for
21 the audit, what the subject matter is. They will hear my
22 analysis, and then the committee will vote and determine whether
23 or not that is a project that they would like us to do.

27 MS. HOWLE: Yes.

28 CHAIRMAN DUNN: Are they the ones that are

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1 charged with the defining the boundaries of any given audit that
2 you do?

3 MS. HOWLE: Typically what they will set out is,
4 the requester will submit a request and have some questions he
5 or she wants us to answer. When we put our analysis of the
6 audit request together, we will explain and basically put
7 objectives together: This is what we can do to answer these
8 questions. So typically, the committee sets the course of what
9 we're going to look at.

10 Now, during the course of an audit, if we feel we
11 need to expand something that we've run across, under our
12 auditing standards, we have to do that. But typically, the
13 mandate comes from our committee as to what the scope of our
14 review will be.

15 CHAIRMAN DUNN: Okay. Why don't we get right to
16 this particular audit, which was begun basically by a request by
17 Senator Peace to the Joint Audit Committee.

18 If this is a good place for you to kind of take
19 off from here, we may want to start, if you don't mind,
20 Ms. Howle -- Oh, by the way, Donna, who is sitting over here at
21 the very end, takes care of all of our IT work, and will be
22 taking care of everything you see up on the screen, because we
23 are going to be talking about a variety of documents. We want
24 to make sure you have those in the same place as we are as we go
25 through them.

26 If we could start basically with Senator Peace's
27 letter, would that be okay?

28 MS. HOWLE: Sure.

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1 CHAIRMAN DUNN: If you could bring up, Donna,
2 it's e8 on the index. If we can, display the first full page.
3 I know it's several pages long.

4 While she's pulling that up, Ms. Howle, why don't
5 you from there go forward as far as what the request was, what
6 work you did, and findings, et cetera.

7 MS. HOWLE: As you can see by the letter, the
8 request was submitted by Senator Peace in August of 2000.
9 Assembly Member Wildman at that time was the Chairman of the
10 Joint Legislative Audit Committee.

11 And basically, what Senator Peace was asking us
12 to do was to look at the operations of both the Independent
13 System Operator, the ISO, and the Power Exchange, which were the
14 two publicly created entities that handled the wholesale power
15 market in California.

16 CHAIRMAN DUNN: Let me interrupt, Ms. Howle,
17 again. My apologies for doing this to you, but I want to make
18 sure.

19 We've been hearing a lot about this. There are
20 some new attendees today. Just very quickly, a description of
21 the ISO versus the PX.

22 MS. HOWLE: The Power Exchange was the entity
23 where most of the buying and the selling was supposed to be
24 taking place for the power. The Independent System Operator was
25 supposed to be looking at purchasing the power to get about
26 three to five percent of the remaining power that the state
27 needs or IOUs needed. So, the IOUs were required to buy and
28 sell through the Power Exchange.

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1 Then, if there was any what's been called "net
2 short," the Independent System Operator had to go out and find
3 that additional power to make sure that enough power was

4 available.

5 CHAIRMAN DUNN: And one phrase you mentioned
6 there was the IOUs. You're referring to the investor owned
7 utilities, referring to PG&E, Edison, and SDG&E.

8 MS. HOWLE: That's correct.

9 CHAIRMAN DUNN: My apologies for interrupting.

10 MS. HOWLE: Oh, absolutely.

11 So, Senator Peace's letter basically asked us,
12 again, to just look at the ISO and the Power Exchange. And
13 primarily, they're the publicly created entities, so we had
14 jurisdiction over those.

15 What he was interested in having us look at were
16 the activities and operations that both of these entities
17 performed in the wholesale electricity market.

18 In addition to that, there were some market
19 surveillance groups that were set up when deregulation, when the
20 whole structure, was set up. He also asked us to look at the
21 activities of those market surveillance groups to see were they
22 properly performing their duties, and if they identified any
23 problems, who did they notify and what was done as a result of
24 the concerns that were raised.

25 CHAIRMAN DUNN: Specifically, which market
26 surveillance working groups are you referring to?

27 MS. HOWLE: We're referring to the ISO
28 Surveillance Committee. We're referring to the PX Market

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1 Analysis Group, and then there were a couple of others. There
2 was a compliance unit with the PX, and then there was another
3 market surveillance group within the ISO. So, groups within
4 those two entities, and then an independent group, some of the
5 witnesses that have previously testified.

6 CHAIRMAN DUNN: And again, for completeness for
Page 12

7 everybody that is here, when you refer to market surveillance
8 groups generically, what are you referring to? What do these
9 people do?

10 MS. HOWLE: Typically, these people are
11 economists who can watch the market, look at bidding strategies,
12 look at the bidding data, and determine whether or not there are
13 anomalies occurring, whether or not market power is being
14 exercised by any of the market participants. That kind of
15 activity.

16 CHAIRMAN DUNN: Okay.

17 Senator Bowen.

18 SENATOR BOWEN: If these market surveillance
19 groups find that there has been a bidding pattern that
20 demonstrates market power, or other manipulation of the market,
21 do they have the ability to take unilateral action to correct
22 the situation?

23 MS. HOWLE: It's my understanding that they
24 don't. My understanding is that the market surveillance groups
25 are required to report to FERC and report to the PUC, the
26 regulatory entities that would be able to make some kind of
27 changes to either the structure of the market or some of the
28 market rules, to deal with the concerns that these surveillance

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1 groups identified.

2 SENATOR BOWEN: Do you know if FERC has its own
3 market surveillance mechanisms?

4 MS. HOWLE: I don't know the answer to that
5 question.

6 SENATOR BOWEN: Thank you.

7 CHAIRMAN DUNN: FERC, again for completeness,
8 Federal Energy Regulatory Commission.

9 MS. HOWLE: That's correct.

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10 CHAIRMAN DUNN: Please continue.

11 MS. HOWLE: Sorry about the acronyms.

12 CHAIRMAN DUNN: That's all right. I'm just
13 trying to make clarification for everybody that this may be a
14 new process for.

15 MS. HOWLE: Basically, that is pretty much the
16 scope. I mean, basically what the Senator was wanting us to
17 look at is, look at the performance of the ISO and the PX, look
18 at the market surveillance, and take a look at the structure of
19 the market to see if there were any concerns that needed to be
20 addressed related to the wholesale electricity market.

21 So, I have some slides, a Power Point
22 presentation, if you'd like to go through that.

23 CHAIRMAN DUNN: Let's do that.

24 MS. HOWLE: Okay, I can preface as it's coming
25 up.

26 Basically, we had a three-chapter report that we
27 issued in March of this year. The first chapter of the report
28 talks about where we specifically looked at the market structure

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1 and looked at the requirement to buy and sell electricity into
2 the PX, the fact that there was a sequential market.

3 What that means is, there was power bought and
4 sold into the PX market, but then there was also the ISO market
5 that was a sequential market. So, if you didn't obtain enough
6 power or enough electricity in the PX market, you could sell it.
7 Or, if you hadn't sold enough, you could sell it in the ISO
8 market, which was sequential.

9 And the important thing to remember is, the ISO
10 had a responsibility to make sure they made up for that net
11 short. The intent was, 95 percent of the power would be bought
12 and sold in the PX market, the Power Exchange, and the ISO would

13 only be picking up between three and five percent.

14 What ended up happening is, much less was being
15 exchanged in the Power Exchange market, and it was basically
16 leaking down into the ISO market.

17 So, the first graph that we have --

18 CHAIRMAN DUNN: Ms. Howle, as she's pulling that
19 up, for practical circumstances, the fact that more purchases
20 were occurring in the ISO market versus the PX market, on a
21 practical level to the average retail ratepayer, what would that
22 mean to them?

23 MS. HOWLE: Well, the retail ratepayers who are
24 still under the rate freeze, they wouldn't feel it. But what
25 the IOUs were ending up having to do was pay a much higher price
26 -- the ISO having to pay a much higher price to obtain power
27 because they had get it; they had no choice.

28 CHAIRMAN DUNN: In other words, the more of the
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1 megawatts that have to be purchased in the ISO market, the
2 higher the price?

3 MS. HOWLE: Absolutely.

4 What this first chart shows you is scheduling, or
5 actually underscheduling.

6 What the blue line is, is the scheduling that
7 occurred in calendar year 1999. This is looking at a high peak
8 period.

9 The orange colored lines is underscheduling in
10 2000. And what this is trying to demonstrate is, if you look at
11 the band of approximately 2000 megawatts in 1999, there was only
12 a few instances where underscheduling exceeded that amount.
13 However, in year 2000, it was hundreds of times.

14 So, what this conclusion basically is, is
15 underscheduling increased significantly in the year 2000 when

16 supply was drying up. So, the buyers and sellers both who were
17 bidding into the Power Exchange market were underscheduling to
18 try and adjust the price. So a buyer, buying into the market,
19 is going to reduce the amount of demand that they are trying to
20 buy to get the price down.

21 The seller is going to reduce the amount they're
22 going to bid into the Power Exchange try and get the price
23 higher because there's a scarcity of the power available.

24 So, what we were seeing in this situation is what
25 we called strategic bidding; i.e., underscheduling in that Power
26 Exchange market to get the price higher. If you're a seller,
27 and even if you don't sell it all, there's really no risk
28 because you can drop down and sell in the ISO market at perhaps

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1 even a higher price than what you would get out of the Power
2 Exchange market.

3 CHAIRMAN DUNN: Senator Bowen.

4 SENATOR BOWEN: Would you see this kind of
5 behavior, or this kind of action, in a market that was
6 competitive?

7 MS. HOWLE: No, this is an indicator of
8 noncompetitive behavior, is basically what our consultants were
9 telling us.

10 SENATOR BOWEN: Just so that I understand, you
11 wouldn't see this in a market that's competitive, because the
12 risk of not being able to sell it all would be so high that no
13 one would withhold in order to get a higher price?

14 MS. HOWLE: That's correct.

15 SENATOR BOWEN: Thank you.

16 Let's just take an example of some other kind of
17 commodity so we can exchange it.

18 How about three-ring notebooks? If we were going

19 out to procure three-ring notebooks in advance, and we couldn't
20 get -- use that or some other office supplies as an example of
21 what might happen, whether this kind of thing could happen.

22 MS. HOWLE: Well, if there's a demand for --
23 let's see. How could I simplify this.

24 If there's a demand for 10 notebooks, and there's
25 12 people who want them, then you're going to be able to ask
26 for a higher price. But if you're a supplier, and you hold back
27 five, and now there's only 5 available, the buyer is going to be
28 willing to pay a higher price for that notebook if they

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1 absolutely have to have that notebook.

2 And that's the thing about electricity is, you
3 have to have electricity to be able to function. So, it's a
4 commodity that people need.

5 And the ISO market in most particular, they have,
6 you know, a reliability responsibility to make sure that there's
7 enough power basically to keep the lights on.

8 SENATOR BOWEN: Do they have a statutory charge
9 that requires them procure at those higher prices, even if they
10 go up to \$1900 a megawatt hour.

11 MS. HOWLE: Right, right.

12 What you'll see in some of the other slides is,
13 is what ended up happening in some instances is, the ISO was
14 forced to go to what is called out-of-market. And that, when we
15 talk about price caps a little bit later, is, their price cap
16 doesn't even apply in that situation. So, that's where you're
17 going to see the ISO paying exorbitant prices.

18 CHAIRMAN DUNN: Please continue.

19 MS. HOWLE: The next chart demonstrates what I
20 was talking about a few minutes ago. It's difficult to read,
21 but what this is showing is, from 1998, you're seeing -- the

22 blue band is the 3 to 5 percent range that the intent of
23 deregulation was to have the ISO buying that amount of power.

24 But as you see, as we get into the year 2000,
25 there's less supply available. There's higher demand because
26 there's growth. And you're seeing that, more and more, a higher
27 and higher percentage of the power that's being purchased now is
28 now being purchased by the ISO.

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1 CHAIRMAN DUNN: Following up a question Senator
2 Bowen asked you earlier, that finding as we got into 2000 would
3 not be anticipated if we had a properly functioning competitive
4 market; is that fair?

5 MS. HOWLE: That's a fair statement.

6 SENATOR BOWEN: One other follow-up.

7 CHAIRMAN DUNN: Go ahead, Senator Bowen.

8 SENATOR BOWEN: When you say less supply
9 available, you're not intending to make a judgment as to whether
10 there was physically less supply potentially available, or
11 whether there was some other reason.

12 You're just reflecting on the actual numbers of
13 what's happening?

14 MS. HOWLE: Right, that's correct.

15 SENATOR BOWEN: Rather than on why there was less
16 supply available?

17 MS. HOWLE: That's correct.

18 SENATOR BOWEN: All right, thank you.

19 MS. HOWLE: Next, this chart is just basically
20 for information purposes, looking at the western grid. WSCC is
21 the western grid. There's approximately 14 states in the
22 western grid.

23 And what we're trying to demonstrate here is, is
24 that California participates in a regional market. And this

25 talks about the fact that in some cases, California imports
26 power from the Northwest, hydro, and in some cases, we export
27 power. But we just wanted to demonstrate that there is an
28 entire region that we're talking about here.

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1 This table demonstrates something that we saw
2 over the course of time. This is -- again, I was talking about
3 out-of-market. So, this is the situation where the ISO in June
4 of 2000 was only purchasing 27,000 megawatts of power. But as
5 you see, as it gets towards October, November, and December,
6 there are 208,000 in November, and 487,000 megawatts of hourly
7 out-of-market megawatts.

8 So, what you're seeing is dramatic change in
9 where the power is being purchased. They're having to go
10 out-of-market to get that power. It's not being exchanged as
11 part of the Power Exchange, and the ISO, as you'll see in the
12 next table, there was a price cap. And this is partly because
13 of the price cap.

14 When the cap started to decrease in the ISO
15 market, the market participants aren't going to get that \$750 in
16 the ISO -- if they stay in the ISO market. So, as that cap
17 drops, your cap is 250, well I want to get more for my power, so
18 I'm not going to sell it into the ISO. So, the ISO has to go
19 out-of-market and basically buy that power either from other
20 states, from municipal utilities, et cetera.

21 So, the two tables that we just showed
22 correspond, really, because you're seeing the price cap going
23 down, and you're seeing the out-of-market purchases going up.

24 CHAIRMAN DUNN: So, in response to lowered price
25 caps, and for clarification, the price caps you're referring to
26 there are mwh, megawatt hour; correct?

27 MS. HOWLE: That's correct.

28 CHAIRMAN DUNN: Seven hundred fifty dollars per
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1 megawatt hour.

2 MS. HOWLE: That's correct.

3 CHAIRMAN DUNN: As those go down, the
4 out-of-market purchases the ISO has to do go up.

5 MS. HOWLE: Right.

6 CHAIRMAN DUNN: And the out-of-market purchases
7 happen to be not covered by the price cap are dramatically
8 higher?

9 MS. HOWLE: That's correct.

10 This chart is showing again some
11 underscheduling. What this is demonstrating --

12 CHAIRMAN DUNN: Ms. Howle, I'm sorry. My
13 apologies.

14 Donna, you don't have to go back to that previous
15 one.

16 When the ISO, who, as Senator Bowen pointed out
17 and you responded, that they've got a statutory obligation to
18 purchase enough electricity to satisfy the demand that is in
19 existence at that given point in time. When the ISO is forced
20 to go out-of-market, as you just testified, and purchase
21 electricity, are the folks that they purchase from any different
22 from the folks who sell to the ISO?

23 MS. HOWLE: No, not necessarily. Because what
24 the market participants could do is sell to a municipal utility
25 which is not subject to the price cap. And then the municipal
26 utility could sell it to the ISO, or they could sell it to the
27 State of Arizona, and then the ISO buys it from the State of
28 Arizona at a higher price.

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1 So, basically you're getting the power from the
Page 20

3ENERGY.TXT

2 same source, but it's kind of an end-run around the price cap,
3 really.

4 CHAIRMAN DUNN: That was end-run, not Enron.

5 MS. HOWLE: Right.

6 CHAIRMAN DUNN: Just kidding, everybody.

7 Let me give another scenario in the sense that a
8 hypothetical generator, Acme Corporation, if they had a trading
9 arm called Acme Trading, they could, in effect, to circumvent
10 the price caps, could say, "I, Acme Corporation, am not going to
11 sell to the ISO. I'm going to sell to Acme Trading Corp." And
12 then the ISO, when it's forced to go out-of-market, may end up
13 having to purchase that electricity from Acme Trading Corp?

14 MS. HOWLE: Right; that's correct, and at a
15 higher price.

16 CHAIRMAN DUNN: Outside the price cap.

17 MS. HOWLE: That's correct.

18 CHAIRMAN DUNN: Okay, I'm going to go to Senator
19 Bowen, but before I do that, coming down the stairs here and
20 joining us is the Honorable Senator Bill Morrow, whose area
21 covers the southern part of Orange County and the northern part
22 of San Diego County.

23 Senator Morrow, welcome.

24 Did you want to do any follow-up, Senator Bowen?

25 SENATOR BOWEN: You just asked the question I
26 wanted to ask, but there is, I suppose, a follow-up.

27 Let's say you have Able Corporation and Baker
28 Corporation. Could Baker sell to Acme Trading, and Acme to

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1 Baker Trading?

2 I mean, there's no reason that you can't sell to
3 somebody else's trading arm; right?

4 MS. HOWLE: I can't imagine -- there wouldn't be

5 any provision that would preclude that.

6 CHAIRMAN DUNN: Senator Escutia.

7 SENATOR ESCUTIA: I think what stunned me was in
8 your description of the sequential market from the Power
9 Exchange to the ISO, and now to the out-of-market, we have
10 basically the same players engaged in what perhaps could be, you
11 know, described as some kind of a shell game in order to
12 basically avoid these price caps.

13 In your experience, have you seen this type of
14 activity occur within this context at any other time? Or is
15 this, you know, some kind of isolated circumstance that has
16 happened as a result of us, right now, in this energy crisis?

17 MS. HOWLE: I think the chart that we showed
18 earlier that had the orange and blue line demonstrated that in
19 1999, when we had sufficient supply, and the demand wasn't as
20 high as it is in the year 2000, you didn't see that
21 underscheduling happening, and having to go out-of-market.

22 But as demand grew, you had the circumstance
23 occurring. So, I would say that in 2000, yes, it's a
24 different --

25 SENATOR ESCUTIA: What about before 1999? Say
26 around '90? We passed this legislation on deregulation in 1996.
27 So, how did the markets react, especially the sequential market
28 scenario in '97 and '98?

2

1 MS. HOWLE: What we saw, and when we looked at
2 some of the market surveillance -- and we have a chart in our
3 presentation here -- is that a lot of the underscheduling really
4 started occurring in late '99 and 2000.

5 There were some concerns that the market
6 surveillance groups identified in '98, but they weren't nearly
7 as significant as in '99 and 2000.

8 SENATOR ESCUTIA: All right. Thank you.

9 CHAIRMAN DUNN: Senator Bowen, did you want to do
10 some follow-up?

11 SENATOR BOWEN: Yes.

12 Again, when you say when we had sufficient
13 supply, what you mean is, when sufficient supply was bid into
14 the market; right? It's not intended to be a judgment as to
15 whether or not there was physically sufficient supply.

16 MS. HOWLE: That's correct.

17 SENATOR BOWEN: That's an important difference,
18 because I think we don't want to judge what reason there was
19 less supply made available. That's the concern of the
20 committee.

21 CHAIRMAN DUNN: Ms. Howle, please continue.

22 MS. HOWLE: What this chart demonstrates is, if
23 you look at -- it's different months, but there's a dotted line
24 or a dashed line at 41,000 gigawatts, I guess.

25 What this is showing is, when the projected
26 demand was at that 41,000 mark, you're seeing underscheduling of
27 7,000, 8,000, 9,000 megawatts. So, it kind of ties in with that
28 first chart where we showed the 2000, and there was

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1 underscheduling.

2 So, when the market participants were aware that
3 there was going to be high demand, there seemed to be a fairly
4 high amount of underscheduling into the market. It's up in the
5 7,000, 8,000, 9,000 megawatts.

6 CHAIRMAN DUNN: And if I was a seller into that
7 market, the practical benefit to me of doing that would be what?

8 MS. HOWLE: To get a higher price.

9 And basically what we concluded with the
10 assistance of our consultants here, they were indicating that

11 this appeared to them to be generators withholding power from
12 the market to bump up the price, to basically manipulate the
13 price higher.

14 CHAIRMAN DUNN: I'm going to ask you to do this
15 one more time. I think they used to say that an A Student only
16 needed to hear it once; a B student twice, and so on. Maybe I'm
17 falling into the B category here.

18 Can you explain that chart, Ms. Howle, one more
19 time?

20 MS. HOWLE: Sure.

21 The 41 on the X axis, 41,000 megawatts is the
22 demand. So, that's the projected demand.

23 CHAIRMAN DUNN: And we consider that, if there's
24 a day with a 41,000 megawatt demand is a high demand.

25 MS. HOWLE: That's a high demand.

26 And what we were seeing is, the chart is titled,
27 "Underscheduling," so when you're projecting that the demand is
28 going to be at 41,000, we were seeing high amounts of

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1 underscheduled; 7,000 megawatts is being underscheduled.

2 CHAIRMAN DUNN: Requiring the ISO to go
3 out-of-market?

4 MS. HOWLE: Correct.

5 CHAIRMAN DUNN: Okay.

6 Senator Bowen.

7 SENATOR BOWEN: Let me talk a little bit, let's
8 explore a little bit the question of who the buyers are in this
9 market. We've been focused on the sellers.

10 Who are the buyers of electricity.

11 MS. HOWLE: The buyers in the ISO and the PX
12 market are the three IOUs, the investor-owned utilities.

13 SENATOR BOWEN: There are a total of three

14 buyers?

15 MS. HOWLE: Right.

16 SENATOR BOWEN: How much work would it take if
17 you were a seller to get a pretty good idea of how much
18 electricity those three buyers are going to be buying on any
19 given day, if you know the weather and the historical use
20 patterns?

21 MS. HOWLE: Right, and that is something that we
22 discuss in the Audit Report, that there's -- there was a lot of
23 information out there available to the market participants
24 related to weather, related to whether there was a prediction of
25 a Stage 2 or a Stage 3 alert in the next day or two.

26 In fact, some information was published on both
27 the Power Exchange and the ISO web sites that allowed the market
28 participants to basically develop their own models and really₂

1 strategically bid the market.

2 SENATOR BOWEN: When you say strategically bid,
3 will you explain what you mean by that?

4 MS. HOWLE: What we mean by strategically bidding
5 is determining: Do I want to bid into the PX market? To
6 basically strategically figure out where I can bid in my power
7 to maximize the price I'm going to get for the power I'm willing
8 to sell.

9 So, do I want to sell it into the PX? Is it
10 going to be a hot day, high demand, et cetera? Therefore, I may
11 not want to bid into the PX. I may want to bid into the ISO, or
12 I may want to, yeah, basically wait and get paid by the ISO
13 because I'm going to get more money for the megawatts.

14 And the risk of me not being able to sell my
15 power is pretty low, because I know it's a high demand day.
16 There may be a Stage 3, which means the ISO's got to go out

17 there, and they've got to just pay basically whatever they have
18 to pay to obtain the power.

19 SENATOR BOWEN: What are the economics of what
20 happens on the margin of where the supply and demand cross?
21 What does it take for someone to decide if they've got 5,000
22 megawatts to sell, that they're better off only offering 4,000
23 and getting a higher price?

24 MS. HOWLE: I'm not sure I understand your
25 question?

26 SENATOR BOWEN: The question is about strategic
27 withholding, and how someone might use the data that was
28 available about what had to be purchased in order to decide.

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1 I mean, it's a basic economic question.

2 MS. HOWLE: Sure, sure.

3 SENATOR BOWEN: With the notebooks, you know, if
4 you only offer 5, and you know 12 are needed, you know you
5 can --

6 MS. HOWLE: Right, you know the price going to go
7 up. So, if you withhold with the power, and you know there's
8 the sequential market, and the ISO has to purchase that power,
9 you sit on it until the price goes up, until, you know, the ISO
10 basically is willing to pay whatever price you ask.

11 SENATOR BOWEN: This doesn't happen in a market
12 that has cost-based rates; right?

13 MS. HOWLE: That's my understanding.

14 SENATOR BOWEN: Is that because under cost-based
15 rates, rates don't go up if there's either physical or economic
16 withholding?

17 MS. HOWLE: My understanding in cost-based rates
18 is, it's based on what your cost is to produce that power
19 certain, a certain margin of profit, and it's not going to go

20 any higher than that.

21 SENATOR BOWEN: So, that takes away the incentive
22 to sell less, or to sell less at a certain period in order to
23 make the price go high in a later period, because the price
24 doesn't go higher.

25 MS. HOWLE: Exactly.

26 CHAIRMAN DUNN: I just want to follow-up with one
27 comment that you had made.

28 You mentioned it creates a situation where there
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1 was low risk to the market participants who, if we create the
2 hypothetical, whether they were basically forcing out-of-market
3 purchases by the ISO, that there was low risk to them that they
4 couldn't sell that electricity in the out-of-market purchases.

5 In fact, probably a more fair characterization,
6 there was no risk if you knew exactly what the demand was, and
7 you knew exactly what the collective megawatt capacity was
8 available to that market on that day.

9 So really, it's almost a no-risk situation if
10 have that data available.

11 MS. HOWLE: I would agree with that.

12 CHAIRMAN DUNN: Let's go forward.

13 MS. HOWLE: What this chart shows is a
14 comparison. And this, Senator Escutia, ties in a little bit to
15 your question.

16 Here what we were finding is, when you had price
17 cap in the ISO market, it had an impact on the PX market. And
18 what happened was, you see the ISO real-time price cap.

19 So, for example, in June of 2000, we're seeing 16
20 hours where the amount paid in the PX market reached the ISO
21 price cap. So, what the market participants knew is, the ISO
22 has a price cap of 750. So, I'm going to use that as my bid

23 into the PX, because if I don't get picked up in the PX market,
24 I will get picked up in the ISO market at 750, so why bid any
25 less into the Power Exchange market?

26 What we saw was, later in the year, you can see
27 August through December, the price cap dropped. Look at 842
28 hours when the amount bid into that Power Exchange market was at
3

1 the ISO price cap level.

2 And what we saw, this, Senator Escutia, back to
3 your question, did not occur. In 1999 and 1998, the PX price
4 never reached the price cap that was in the ISO market. So, it
5 never happened in '99 and '98, but in 2000, we saw it happen,
6 you know, a fair amount in June and July, and then a dramatic
7 increase later in the year.

8 CHAIRMAN DUNN: From your analysis, the work that
9 you did, Ms. Howle, didn't happen in '98; didn't happen in '99;
10 it happened in 2000. Why?

11 MS. HOWLE: Well, I think it happened in 2000
12 because of the nature of the market. Things were getting tight;
13 demand was increasing; and their ability to manipulate the
14 market, basically, to maximize their prices, they were learning.

15 As our consultants looked at that, they said the
16 market participants were beginning to understand how to
17 strategically bid into the market. And that really began to
18 show itself later in calendar year 2000.

19 So, it was basically them getting better at
20 strategically bidding into the market to maximize their price.

21 CHAIRMAN DUNN: In lay terms, they could do this,
22 I mean, it happened because it could happen.

23 MS. HOWLE: Yes.

24 CHAIRMAN DUNN: In other words, basically there
25 was nothing, no consequence to this sort of activity occurring

26 by the time we reached 2000.

27 MS. HOWLE: That's correct.

28 CHAIRMAN DUNN: And since there was no

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1 consequence for it, it happened.

2 MS. HOWLE: That's correct.

3 This chart, as I discussed a little bit earlier
4 in my testimony, is related to the market surveillance work that
5 we were asked to do, to look at the ISO Surveillance Committee,
6 the PX Market Monitoring Committee. Were they performing the
7 functions that they were required to do, and how early did they
8 identify problems?

9 As you can see, and this is the top half of the
10 table, this is August of 1998 -- that should say 1998 -- was the
11 first time that the ISO Surveillance Committee started to
12 identify some anomalies in the market. It was related to
13 ancillary services, which are services that they have to -- you
14 know, it's the extra power they either have on hold in the event
15 a generator goes out. There's an outage; they can tap into that
16 power immediately.

17 But what this is demonstrating is that the market
18 monitoring groups were starting to see some problems as early as
19 August of 1998.

20 The right-hand column is, okay, when we talked to
21 those market surveillance groups, we said, "Okay, you identified
22 these problems. Who did you notify?" And CPUC is the
23 California Public Utilities Commission; FERC is the Federal
24 Energy Regulatory Commission.

25 And what we did is, we went through and
26 identified the different reports that these market monitoring
27 groups put together and where they identified concerns related
28 to the market, looking at the sequential structure, the ability

1 of generators to set high prices, generators underscheduling. A
2 lot of the concerns that we discussed in the first chapter of
3 the Audit Report.

4 This is the second chapter, where we talked about
5 market surveillance, and we were trying to determine, did these
6 groups do their job? Our conclusion is, yes, they did their
7 job. Unfortunately, when the information was conveyed to the
8 PUC, a few actions were taken by the PUC, i.e., long-term
9 loosening the restrictions on long-term contracting.

10 When they reported some of the information to
11 FERC, little was done by FERC.

12 CHAIRMAN DUNN: Is that true up to today?

13 MS. HOWLE: I think that's changed a bit today.
14 Through the course of our audit -- as I said, we issued this in
15 March of 2001, just a few months ago. Not much had been done at
16 that point.

17 CHAIRMAN DUNN: All right.

18 MS. HOWLE: All I really wanted to talk about
19 here is, again, this is an example, this table in our report is
20 an example of the concerns that the market monitoring groups
21 found. Then we followed up in asking them, you know, what did
22 the PUC do?

23 The PUC, of course, as we know, loosened up some
24 of the restrictions on long-term contracting; however, they
25 limited the amount the investor-owned utilities could purchase
26 through those long-term contracts. They also reserved the right
27 to go back and do a prudency review to make sure that those
28 contracts were at a reasonable price, et cetera.

1 So, there may have been some reluctance on the
2 part of the investor-owned utilities to enter into a lot of

3 long-term contracts.

4 But what we found when we talked to the PX is
5 that by doing that, those investor-owned utilities did save a
6 fair amount of money. I'd have to look in the Audit Report to
7 get the exact dollar amount. Doug tells me 709 million is what
8 was saved.

9 The bigger concern that we had, and I know there
10 will be testimony from FERC, is that there were instances where
11 FERC was notified of some pretty serious concerns by the ISO
12 Surveillance Committee; i.e., there was a report by the ISO
13 Surveillance Committee that FERC looked at and agreed that that
14 report had demonstrated proper methodology and analysis to
15 determine that market power was exercised in June of 2000.

16 And in a FERC report that we looked at, they
17 acknowledged that that methodology was appropriate, and it was a
18 fair assessment, but they felt that there needed to be more
19 analysis.

20 Unfortunately, at that point in time, more
21 analysis wasn't done. FERC's conclusion in its report was, my
22 understanding and what we say in our Audit Report, is that they
23 felt that the California market still needed to be able to --
24 there needed to be some changes in the market itself, rather
25 than go in and start doing more investigation, because would be
26 difficult to determine whether it was a flaw in the market, or
27 whether it was truly an exercise of market power.

28 Our concern that we raised in the Audit Report
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1 is, here are these market surveillance groups doing their job,
2 identifying something that they consider an exercise of market
3 power. FERC looks at their methodology; agrees that it's an
4 appropriate methodology, yet chooses not to conduct further
5 study that they felt was necessary.

6 CHAIRMAN DUNN: Ms. Howle, we've used the phrase
7 "the exercise of market power."

8 From your perspective, how would you define that
9 phrase, the "exercise of the market power?"

10 MS. HOWLE: Similar to what your definition was
11 earlier. It's just the ability to exercise power in the market
12 to manipulate the price in a noncompetitive -- you know, there's
13 no competitive consequences, as you said earlier.

14 CHAIRMAN DUNN: All right.

15 MS. HOWLE: That pretty concludes the two
16 chapters of the report. I think that's our last handout in the
17 presentation.

18 The only other thing that we do discuss in the
19 Audit Report is, we do have a third chapter, and that looks at,
20 you know, some of the concerns, things that occurred in
21 California, and actually in the western region, that were
22 outside of any regulatory agency's control. You know, the hot
23 weather, natural gas prices went way up; NOx emissions, prices
24 went way up.

25 So, there were other factors that were, you know,
26 playing into this situation that occurred in 2000 and continuing
27 to occur.

28 CHAIRMAN DUNN: Senator Bowen.

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1 SENATOR BOWEN: Now I'm going to focus on the
2 demand side. A number of times you've referred to demand
3 increasing.

4 But it's my understanding that demand has not
5 significantly increased, or at least not anywhere commensurate
6 with what the price increases have been. Can you clarify?

7 MS. HOWLE: I think that's a fair statement. I
8 think there was an increase in demand in the region.

9 SENATOR BOWEN: In the region.

10 MS. HOWLE: In the region. In the entire western
11 region. We're not talking specifically to California.

12 That's the point we were trying to make in our
13 chapter is, this is not isolated to California. This is, you
14 know, the population growth, et cetera, in the western region,
15 but certainly not, you know, to correlate with the increase in
16 the price that has occurred over the last year.

17 CHAIRMAN DUNN: I've got a number of areas I want
18 to explore, Ms. Howle. I just want to also read, and I don't
19 think differs very much. Mr. Drivon handed to me while you were
20 just speaking there the Department of Justice. Actually, this
21 is from, I believe it's the Staff Report to the FERC from Summer
22 2000, or about Summer 2000. It says, "Department of Justice,
23 DOJ, Guidelines Define Market Power."

24 And the reason we're doing this is, we want to
25 make sure everybody understands the phrase, market power, is a
26 term of art. We want to make sure we're all on same page with
27 respect to it, because it's very, very critical in any analysis
28 of the wholesale electricity market to really come to a general

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1 agreement on the definition of market power.

2 But the Department of Justice, the U. S.
3 Department of Justice, defines market power as, quote, "the
4 ability profitably to maintain prices above competitive levels
5 for a significant period of time," end quote.

6 Which is basically the same thing. I can raise
7 the price without competitive consequence, my lay
8 interpretation, but basically the same thing.

9 The first area, Ms. Howle, I want to explore a
10 little bit about is, throughout your work that was initiated
11 with Senator Peace's request to the Joint Audit Committee, you

12 are bound by certain confidentiality provisions in your normal
13 day-to-day work as the State Auditor in any audit that you do.

14 But you also ran into confidentiality objections,
15 problems, obstacles, in the course of your investigation; true?

16 MS. HOWLE: Yes, that's correct.

17 CHAIRMAN DUNN: Let's first define, just
18 generally, the normal confidentiality requirements you have to
19 operate under as the State Auditor, no matter who or what it is
20 that you're auditing.

21 MS. HOWLE: Okay. Whenever we are -- our
22 statute requires us, when we are in the course of conducting an
23 audit, that the information that we obtain, the issues that we
24 are identifying, remain confidential. Therefore, if the Joint
25 Legislative Audit Committee was interested in how's it going on,
26 you know, the audit of the ISO or the PX, I cannot discuss that
27 anyone, either the Legislature, or the general public, the
28 media. That audit report and all the work that we're doing has³

1 to remain confidential until that report is a final document and
2 it's issued public.

3 Then, if there is information that we've obtained
4 from an agency, that that agency has certain statutory
5 requirements that require them to keep that information
6 confidential, we have to abide by that same requirement.

7 So when we complete an audit report, we have
8 working papers that support our conclusions and our analyses.
9 And what we have to do, we have a responsibility, is, we
10 separate those work papers into documents that are public
11 documents, and documents that would be confidential or nonpublic
12 documents. And we have to protect those via our statute.

13 Now, if there's information that we've obtained
14 from an agency, and that agency has told us, "This is

15 confidential information," and they give us the statute, or
16 whatever the provision is that requires us to do that, we will
17 do that and protect that information.

18 CHAIRMAN DUNN: Okay, even though you wanted to
19 include it in your Audit Report, because it would be normally
20 confidential if it was simply part of your working papers to
21 prepare that Audit Report.

22 MS. HOWLE: Right. And if there is information
23 that we obtain that's confidential, typically what we'll do is,
24 if we feel we need to report an issue, we'll report the
25 information in aggregate form. We won't violate that
26 confidentiality requirement.

27 CHAIRMAN DUNN: Let's move into the
28 confidentiality objections, concerns, obstacles, that you

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1 encountered with respect to this particular audit.

2 MS. HOWLE: We -- in working with the ISO, they
3 were concerned about confidentiality, the market participants.
4 They have some requirements -- it's my understanding that they
5 have requirements under the FERC tariffs to notify the market
6 participants if they're going to be providing information to an
7 outside entity, like your committee, like us.

8 In working with the attorneys at the ISO, we
9 explained to them, my staff counsel explained to them, "Here are
10 our confidentiality requirements. We protect the information."

11 The ISO was -- we had to negotiate for a fair
12 amount of time, a few months, with them before we were able to
13 get some information. We tried to get the audit started in
14 September. We really didn't get things in place as far as an
15 agreement, confidentiality agreement with the ISO, until, I
16 think, November or December.

17 And one of the concerns was, the ISO felt that

18 they had to notify the market participants of the types of
19 information that we were asking for. They did that. We had no
20 problem with that. We had no problem with them sharing, of
21 course, our statute. Basically, we call it the "stand in the
22 shoes" provision, which is, our statute says, if we're
23 conducting an audit of an entity, we have access to any and all
24 records that that entity has access to.

25 So, for example, if we're auditing the ISO, we
26 basically become the ISO. So, we have access to any records
27 they have access to.

28 And we were fine with the ISO sharing that

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1 information with the market participants. They did that, and
2 the market participants objected to our confidentiality. They
3 didn't feel that our confidentiality statute was strong enough.

4 CHAIRMAN DUNN: Specifically, who of the market
5 participants objected, to your knowledge?

6 MS. HOWLE: Which market participants? I think
7 pretty much all of them. I can give you the specific names.

8 CHAIRMAN DUNN: If you could, just share a kind
9 of representative sample so we understand who it is we're
10 referring to here.

11 MS. HOWLE: I have the information here.

12 The first letter is from -- and these are letters
13 that were sent to the ISO and also to ourselves. First one is
14 Duke Energy, North America.

15 The next one is Southern Company Energy
16 Marketing.

17 I'm trying to find the rest of them in here.

18 Okay, I've got it.

19 I said Duke Energy, North America. Duke Energy
20 Trading and Marketing. Dynegy Power Marketing. Reliant Energy

21 Power Generation, Incorporated. Reliant Energy Services,
22 Incorporated. Southern Energy, Incorporated. Williams Energy
23 Marketing and Trading Company. And AES Corporation and their
24 affiliates.

25 CHAIRMAN DUNN: All objected to --

26 MS. HOWLE: All objected to us having access to
27 certain records because they were concerned that our
28 confidentiality statute wasn't strong enough to comply with the
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1 FERC tariffs.

2 CHAIRMAN DUNN: And when you reached an agreement
3 with the ISO late last year, I believe it was November or
4 December, over the confidentiality that would be utilized in
5 delivering those documents to you, did the market participants
6 withdraw their objections? Were they satisfied, to your
7 knowledge?

8 MS. HOWLE: Basically, what the market
9 participants did is, they wrote the letters, and then we had a
10 meeting. I had a personal meeting with Terry Winter at the ISO,
11 and I said, we need to get going on this audit. We've got a
12 responsibility, you know, to report back to the Legislature.

13 So, what the ISO did is notify the market
14 participants, "Unless you file some objections, we're going to
15 turn this information over to the State Auditor's Office at such
16 and such a date."

17 What happened was, the market participants got
18 together and filed an order with FERC asking for us to not get
19 access to those records.

20 It's my understanding that there was no action
21 taken by FERC. So, after a certain time period expired, the ISO
22 basically started giving us the information that we had been
23 asking for.

24 Okay, my staff counsel wants to make sure I
25 clarify.

26 What the participants were asking for were more
27 strict confidentiality requirements than what our statute had.
28 We feel our statute's very strong, but they felt otherwise.

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1 That's what the filing was about.

2 CHAIRMAN DUNN: Certainly seems pretty strong.
3 In your description, you ain't giving it to anybody.

4 MS. HOWLE: Right. If we release confidential
5 information, it's a misdemeanor. I mean, we're very careful
6 about that.

7 When we audit agencies, of course we're sharing
8 information with them. We give them a draft copy of the
9 report, and we have, you know, all kinds of warnings that,
10 pursuant to this section of our statute, this information is
11 still confidential: you cannot discuss it; you can't leak it.
12 We're very, very strong about that.

13 CHAIRMAN DUNN: Including up to today, other than
14 what is in your published Audit Report, you feel you cannot
15 share the information you gathered in preparing that Audit
16 Report with anyone outside the State Auditor's Office?

17 MS. HOWLE: The information that is confidential.
18 Information that's public information in support
19 of the report we can share. The confidential information, no,
20 we cannot.

21 And what the agreement with the ISO says is that
22 if we are asked for that information, we have to notify the ISO
23 so that they can notify the market participants so that they can
24 determine whether or not they want to object to us releasing
25 that information.

26 Basically, the ISO and the market participants

27 have to give us permission. We're not going to release that
28 information.

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1 CHAIRMAN DUNN: Go ahead.

2 MS. HOWLE: Just a clarification.

3 CHAIRMAN DUNN: On the advice of counsel.

4 MS. HOWLE: On the advice of counsel, we have to
5 notify the ISO, and then the ISO believes that it has to notify
6 the market participants about the confidential information.

7 CHAIRMAN DUNN: We're going through the same
8 process, as you know, as well. We are boldly going where you
9 have already been.

10 MS. HOWLE: Yes, we empathize.

11 CHAIRMAN DUNN: Go ahead, Senator Bowen.

12 SENATOR BOWEN: I'm really wondering here about
13 the whole concept of accountability. If there's no way to get a
14 public entity of any kind, including the State Auditor, access
15 to this information on timely basis, how do we ever assure
16 ourselves that what's going on in the market is square?

17 I mean, the ISO is not a state agency; right? It
18 is created by the state, but it is not a state agency.

19 MS. HOWLE: It's a publicly created entity, and
20 our statute allows us to audit them.

21 SENATOR BOWEN: Right, but it is not, for
22 example, subject to the Public Records Act.

23 MS. HOWLE: I don't know. We don't think it is.

24 SENATOR BOWEN: So, in your view, do we have a
25 mechanism for accountability that's sufficient to serve the
26 public interest?

27 MS. HOWLE: In my opinion, I share the same
28 concern you that you have. It was, to be quite honest, very

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1 frustrating as the State Auditor's Office, because we have a
2 very strong statute, and we respect it. And we feel that we
3 provide an important service to the State of California.

4 We wanted to go out and perform our job, perform
5 due diligence, and it was very frustrating to try and start in
6 September, and have to negotiate for a number of months before
7 we could even start getting information that we needed.

8 SENATOR BOWEN: You would think that you were,
9 you know, looking for the secret code to the nuclear arsenal,
10 from what you described.

11 CHAIRMAN DUNN: I think that's easier to get.
12 Senator Escutia.

13 SENATOR ESCUTIA: Perhaps I missed this, but I'm
14 very interested in finding out what are the grounds for these
15 claims of confidentiality? Are these legally recognized
16 relationships, attorney-client, work product? What were the
17 grounds for the claims of confidentiality?

18 MS. HOWLE: The information that my staff is
19 telling me is, the objections or the concerns that the market
20 participants had is, the information that we were hoping to get
21 is confidential bidding data, and they were claiming that it was
22 proprietary information.

23 SENATOR ESCUTIA: So, they were claiming
24 something along the lines of what, a trade secret?

25 MS. HOWLE: May I have my staff counsel, because
26 she worked with the attorneys at the ISO and understood some of
27 the FERC tariffs. So, I think she may do a better job than I.

28 CHAIRMAN DUNN: Let me interrupt. Sorry to do
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1 this to you, Sharon, but since we're going to have you, we've
2 got to swear you in. Sorry to do this.

3 Erik.

4 MR. LANGE: Please stand, state your name.

5 MS. REILLY: Sharon Reilly.

6 [Thereupon the witness,

7 SHARON REILLY, swore to tell

8 the truth, the whole truth, and

9 nothing but the truth.]

10 MR. LANGE: You may be seated.

11 SENATOR ESCUTIA: I was just curious. Perhaps

12 it's the fact that I'm the Chair of the Judiciary Committee.

13 I'd like to find out what are the grounds for the
14 claims of confidentiality?

15 MS. REILLY: My understanding is that the claim
16 comes from the FERC tariff, that there is some protection for
17 competitive bidding data.

18 Off the top of my head, I'm not sure how long
19 that claim is.

20 SENATOR ESCUTIA: There is some kind of a FERC
21 statute that allows them to just unanimously assert
22 confidentiality? Is the presumption of that FERC statute that
23 all documents are closed, or that all documents are open subject
24 to certain exemptions?

25 MS. REILLY: The question would probably be
26 better put to the ISO, because it's the tariff that the ISO has
27 with FERC.

28 Our understanding is that it's the competitive
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1 data, along the line of trade secrets and proprietary
2 information.

3 We also had assertions of attorney-client
4 privilege.

5 SENATOR ESCUTIA: So, they're saying that bidding
6 data is a trade secret, proprietary information, and they're

7 also claiming attorney-client?

8 MS. REILLY: And I think it's primarily coming --
9 we can get you the specific language from the FERC tariff.

10 SENATOR ESCUTIA: You say from the FERC tariff;
11 did I hear that right?

12 MS. REILLY: The FERC tariff between the ISO and
13 FERC.

14 SENATOR ESCUTIA: Maybe this question is best
15 addressed to the person from FERC, but since I don't know
16 anything about this FERC tariff, is there some type of a
17 presumption that all documents are open, subject to certain
18 negotiations as to which documents will remain closed? Or is
19 the presumption that all documents are closed, subject to
20 certain negotiations to which documents will remain open?

21 MS. REILLY: I don't know the answer to that
22 question, I'm sorry.

23 SENATOR ESCUTIA: Then I will suspend that
24 question until the FERC counsel comes on board.

25 Thank you, Mr. Chairman.

26 CHAIRMAN DUNN: Senator Bowen.

27 SENATOR BOWEN: As we're discussing this, and
28 following on the previous discussion we had about there being a
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1 grand total of three buyers, it occurs to me that we have a
2 situation in which all of the buying patterns are
3 public, publicly available. And none of the information about
4 the sellers' practices are public, at least for six months, and
5 perhaps for longer.

6 Is that an accurate description of the situation
7 we're dealing with?

8 MS. HOWLE: Based on my understanding, yes, that
9 is an accurate description.

10 SENATOR BOWEN: We'll have some further
11 conversations about that, but it's hard to imagine how you can
12 have a competitive market where you've got three buyers.
13 They're required to purchase in a certain way. All that data is
14 publicly available. And the sellers get to claim that
15 everything they're doing is a trade secret.

16 CHAIRMAN DUNN: Just a few other areas,
17 Ms. Howle, I want to cover with you.

18 I believe you stated in the description of the
19 scope of your audit, it included looking at the market
20 surveillance activity of the ISO and the PX; correct?

21 MS. HOWLE: That's correct.

22 CHAIRMAN DUNN: As I indicated before, we have
23 had several witnesses in past hearings from the Market
24 Surveillance Committees, Market Analysis Committees, testify.
25 Each of them laid out what their findings were, subject, of
26 course, to their own confidentiality requirements they have to
27 operate under.

28 And each of them testified to what they

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1 considered to be an exercise of market power by a variety of
2 market participants, and a variety of acts of potential market
3 manipulation for purposes of impacting the prices, and so forth.

4 In your audit, did you find any problems,
5 deficiencies, or criticisms with the methodology that was used
6 by the market surveillance entities within the ISO and the PX?

7 MS. HOWLE: No.

8 CHAIRMAN DUNN: I want to be honest with you,
9 Ms. Howle, why I asked that question. There has been some
10 public criticism post the testimony of those individuals in
11 which some of the market participants' representatives referred
12 to their work as, quote, "voodoo economics," end quote.

13 Do you agree with that characterization of the
14 work of the Market Surveillance Committee and Analysis
15 Committees of the ISO and PX?

16 MS. HOWLE: Absolutely not.

17 When we looked at the Market Surveillance, the
18 work that they did, interviewed those folks, in fact, the
19 consultants that we used and our staff were quite impressed with
20 the work that they had done.

21 CHAIRMAN DUNN: And through the various
22 consultants and others you've talked to during the course of
23 your audit, did anybody express criticism of the methodology
24 used by those individuals?

25 MS. HOWLE: No.

26 CHAIRMAN DUNN: Donna, can you bring up, let's go
27 to e9.

28 Now I want to tell you what they're saying about
4

1 your work.

2 MS. HOWLE: Always complimentary; right?

3 CHAIRMAN DUNN: Isn't this fun.

4 Senator Escutia just asked the question of, who
5 is the "they" that I am referring to.

6 What you find up on the screen, Ms. Howle, at
7 this point in time, is a handout that was delivered by a
8 representative of a trade organization, primarily the
9 generators, called, and it's on the last page, called the IEP.
10 It's the Independent Energy Producers.

11 This was handed out during the course of one of
12 our earlier hearings. Without reading the whole thing,
13 basically it's a description published or put out by the IEP in
14 which they say the market participants have been investigated.
15 I think it starts with, "11 investigations, and nobody has found

16 anything wrong," and in fact they use these, quote,
17 "investigations" to argue that they've done everything correct
18 in their behavior on the wholesale market.

19 You're lucky enough to be listed as number eleven
20 on that, if we can go to Page 3, Donna. If we could, highlight
21 Number Eleven.

22 That look familiar?

23 MS. HOWLE: Yes.

24 CHAIRMAN DUNN: I want to be very specific about
25 this question, because I'm not trying to hide the ball here. At
26 least this person, myself, was very disturbed about this
27 particular handout.

28 I don't mind anybody, obviously, citing reports
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1 that they think are advantageous to them. I want to be very
2 specific on the following question.

3 In your opinion, is it a fair use of your audit
4 to cite it as an investigation that examined the activities of
5 the market participants, including the power generators, and
6 exonerated them of any wrong doing in this crisis, including any
7 role they may have had in the high prices in the wholesale
8 energy market?

9 Is that a fair use of your report?

10 MS. HOWLE: No, that is not a fair use of our
11 report.

12 CHAIRMAN DUNN: And in fact, I want to quote one
13 sentence from your report that states, "Just as one factor,
14 strategic bidding is one factor that significantly contributed
15 to the high prices in 2000."

16 Correct?

17 MS. HOWLE: That's correct.

18 CHAIRMAN DUNN: In fact, as I talked to you

19 before about everybody that you talked to in putting your report
20 together agreed that there was an exercise of market power that
21 contributed to higher prices; is that not true?

22 MS. HOWLE: That is true.

23 CHAIRMAN DUNN: You have another audit report in
24 the works.

25 MS. HOWLE: Yes.

26 CHAIRMAN DUNN: I know you've already talked
27 about the confidentiality provisions.

28 I'm sorry, my apologies, Senator Bowen.

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1 You've already talked about your confidentiality
2 provisions that apply to you.

3 Please share with us what you can about that
4 particular report, including what its scope is, and when you
5 expect to publish that report?

6 MS. HOWLE: That report will be published on
7 Monday. In fact, I'm going back to Sacramento this afternoon to
8 do a final review and sign the report so we can get it
9 distributed. It will be issued Monday, May 21st.

10 The scope of the audit is pretty much, all I can
11 discuss, the scope of that audit, we've looked at two again
12 state agencies: the Public Utilities Commission and the
13 California Energy Commission.

14 What we looked at in the scope of that audit was
15 looking at, related to the PUC, transmission, their process for
16 siting transmission, some of the requirements that they had to
17 complete under AB 970, which was legislation that was passed to
18 deal with programs to conserve energy.

19 And looking at the Energy Commission related to
20 siting and approval of plants, construction of plants in
21 California.

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22 CHAIRMAN DUNN: And I suppose if we all
23 collectively promise not to tell anybody, you still can't tell
24 us what's going to be in there.

25 MS. HOWLE: That's correct.

26 CHAIRMAN DUNN: It was worth a try.

27 MS. HOWLE: I'll be happy to brief you on
28 Monday, the 21st, when it goes public.

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1 In fact, the Joint Legislative Audit Committee
2 has scheduled a hearing on May 22nd, Tuesday, to discuss three
3 audits that are going to be on the agenda, but also to have us,
4 myself and the Project Manager, Mr. Cordiner, present the
5 findings from that audit report.

6 CHAIRMAN DUNN: Before I turn it over to Senator
7 Morrow for some questions, this is the first time we've
8 mentioned the CEC, the California Energy Commission.

9 Just briefly for everyone, describe what's the
10 purpose of the Energy Commission?

11 MS. HOWLE: The purpose of the California Energy
12 Commission is to site and -- approve applications for siting and
13 construction of power plants in California.

14 CHAIRMAN DUNN: Okay.

15 Senator Morrow.

16 SENATOR MORROW: Thank you, Mr. Chairman.

17 Good morning, Ms. Howle. I apologize for being
18 late. I missed your opening comments.

19 I want you to know that I have studied the entire
20 Auditor's Report. And as I've come to expect with the product
21 of your office, it's certainly in line with that. It's a very
22 professional job; it's very thorough. My compliments to you.

23 MS. HOWLE: Thank you.

24 SENATOR MORROW: A couple questions I have. Let

25 me take the issue of confidentiality one step further.

26 It's my understanding, and I know that this
27 committee has subpoenaed basically all the information that you
28 have obtained from the ISO, including more. I anticipate we're⁵

1 going to receive that information. What we do with it after
2 that remains to be seen on some of the confidentiality issues.

3 But in reading your report, you indicated, the
4 report indicated that FERC itself had concluded that evidence
5 was inconclusive in determining whether sellers exercised actual
6 market power. And they had concluded, again FERC, that further
7 study would be needed to substantiate charges of market power
8 abuse.

9 Apparently, FERC had never conducted that study,
10 and your report noted that last December, at the Western
11 Governors' Association, FERC informed that association that it
12 would not pursue generator repayments to purchasers, as it would
13 be time consuming if not and an impossible task. That is to
14 say, it'd be too difficult to prove by individual firms any
15 market power abuse.

16 I'd like to know whether or not you agree? On
17 the basis of what information that you've been able to glean, if
18 whether or not you agree with FERC's conclusions in that
19 respect?

20 MS. HOWLE: Based on the information that we
21 have, it's difficult to say whether or not it would be an
22 impossible task.

23 If the data is available, and you have the
24 appropriate individuals looking at the data, I would think it
25 would be a task that could be accomplished, particularly since,
26 when we talked to the market surveillance groups, they had
27 looked at information. And FERC had looked at the methodologies

28 that they had used and concluded that those methodologies were
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1 appropriate, and that the conclusion reached by the market
2 surveillance groups was that there was market power exercised.

3 SENATOR MORROW: But as far as bringing it down
4 to the individual level, how problematical would that be?

5 MS. HOWLE: You know, Senator Morrow, I can't
6 answer that question, really. Personally, I don't have enough
7 information to be able to give a fair answer.

8 SENATOR MORROW: What, if anything, in your
9 opinion can FERC be doing, or this committee, in order to
10 conduct a more thorough investigation as to the abuse of market
11 power?

12 MS. HOWLE: I think one of the concerns, as we
13 mentioned in the Audit Report, if there's data available, they
14 could be looking at the data.

15 I don't know what activities they've undertaken
16 since we issued our Audit Report, whether they're doing that or
17 not. I know there's a gentleman from FERC here who's going to
18 testify.

19 SENATOR MORROW: That data is accessible by FERC
20 only at this point; is that correct?

21 MS. HOWLE: That's my understanding.

22 SENATOR MORROW: Thank you.

23 CHAIRMAN DUNN: Thank you, Senator Morrow.

24 Ms. Howle, I just have one last area I want to
25 cover with you, and subject to any other questions by the
26 Members, we may be nearing the end for you.

27 When the initial request was made by Senator
28 Peace to the Joint Audit Committee, which was ultimately

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1 approved by the Joint Audit Committee, that therefore you were

2 charged, your office, with doing this audit, fair to state that
3 at the time that the directive came from the Joint Audit
4 Committee, there's nobody permanently on staff with the State
5 Auditor's Office that had detailed knowledge about this complex
6 energy market, I would presume; correct?

7 MS. HOWLE: That's a very fair statement.

8 CHAIRMAN DUNN: Probably an under statement, is
9 what it really is. And that's probably true with many of the
10 audits that you do.

11 MS. HOWLE: Many of the audits, if it's in a
12 specialized area.

13 I think what we consider ourselves is as experts
14 at looking at process and programs, to be able to go in and very
15 quickly learn how a program is supposed to function, and then
16 evaluate against that criteria.

17 But a very specialized area like this energy is
18 clearly beyond the expertise of the individuals currently
19 employed at the office.

20 CHAIRMAN DUNN: In fact, when this audit was
21 commenced, you reached to outside consultants for purposes of
22 completing the audit?

23 MS. HOWLE: That's correct.

24 CHAIRMAN DUNN: Tell us how that works? How did
25 that work within the State Auditor's Office in this particular
26 circumstance?

27 For example, we've talked in the past about how
28 you have a Project Manager at all times, and then certainly when
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1 you reach out to consultants.

2 Tell us how that process unfolded within the
3 State Auditor's Office with respect to this audit.

4 MS. HOWLE: The process unfolds whereas the
Page 50

5 executive management group -- myself, the Chief Deputy, my chief
6 counsel, and the Project Manager -- will sit down and we'll say,
7 do we have the expertise? No, we don't. We need to find it.

8 So, what we would do is go out and do some
9 research. We did some internet research. We contacted an
10 individual at the National Conference of State Legislators.
11 They have individuals who are experts in various fields. We
12 contacted that individual in early October and asked him for
13 some names of firms that may have expertise in this area. He
14 gave us a list of names.

15 We, you know, basically asked around; asked
16 other consulting firms, individuals that we know work in this
17 field. Not in the energy field, but in management consulting,
18 basically, "Hey, we've got an audit request here. It's a public
19 record, and we're looking for this kind of expertise."

20 So then, once we got the identification of the
21 names, we looked at the qualifications of these different firms,
22 what kind of work they had done in the past, and then identified
23 a list of five or six firms and contacted them.

24 And I didn't participate personally, but my staff
25 and my staff counsel interviewed some of the different firms to
26 see if they had done work, and then also determine whether or
27 not they were currently doing work in the field, to determine
28 whether or not there would be a conflict of interest, because

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1 certainly, that would be a concern that we would have.

2 Then we narrowed it down to a few firms, and then
3 interviewed them, discussed with them what the scope of what we
4 would be asking them to do would be, based on what the Joint
5 Legislative Audit Committee approved.

6 Then we contracted in two phases. The first
7 phase was to do what we called scoping, which is basically to go

8 out for a couple of weeks, interview folks at the ISO, interview
9 people at the PX, in the context of what we were asked to do,
10 and come up with a proposal as to how we could go about doing
11 the audit.

12 Then the second phase is basically the contract
13 for the audit work itself.

14 CHAIRMAN DUNN: Okay.

15 Obviously, when you reach out to outside
16 consultants for any particular audit, this one included but not
17 an exception, you look for consultants that clearly are
18 experienced and knowledgeable in the given area, that have
19 ideally no conflicts involved, or at the very least, where you
20 can minimize or work around the conflict that may arise; true?

21 MS. HOWLE: Yes, that's correct.

22 CHAIRMAN DUNN: Is it fair to say that in this
23 particular situation, finding any experienced, knowledgeable
24 consultants/experts that don't have a conflict is darned near
25 impossible?

26 MS. HOWLE: That's very fair. We looked hard and
27 long, and a lot of the consultants -- to be able to find someone
28 who had enough knowledge to be able come in.

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1 And one of the things that we deal with is, when
2 we get an audit approved, we want to be responsive and get that
3 work done very quickly. So, we need to be able to hire someone
4 in a very short turnaround, be able to perform our due
5 diligence, but bring somebody on board fairly quickly.

6 And we don't want that individual to have to
7 develop some kind of learning curve, like we do. We want them
8 to come in, be our expert and be able to teach us, and explain
9 to us how things work.

10 So, yes, it's practically impossible to find

11 someone who has the knowledge and the expertise, but doesn't
12 have a conflict, or hasn't done work in the field.

13 CHAIRMAN DUNN: And that was particularly
14 difficult with this audit?

15 MS. HOWLE: That's correct.

16 CHAIRMAN DUNN: I believe you ultimately retained
17 the services of three consultants for the audit.

18 MS. HOWLE: Yes.

19 CHAIRMAN DUNN: Can you identify those for us?

20 MS. HOWLE: The primary contractor is TXP,
21 Incorporated. And then we had two additional contractors,
22 Pacific Economics Group and J.A. Wright -- I want to make sure I
23 get the name correct -- J.A. Wright and Associates,
24 Incorporated. That was the third contractor.

25 CHAIRMAN DUNN: Can you go through each of those
26 briefly and describe for us any conflict of interest concerns
27 that arose, and how they were resolved before retention?

28 MS. HOWLE: J.A. Wright and Associates is an 5

1 individual who is from the east coast, North Carolina. It was
2 an individual who had worked for Duke in the past. It had been
3 related to regulatory activities in North and South Carolina.

4 When we discussed it with him, we explained to
5 him what the scope of our review was, and it was not to look at
6 the generators; it was not to look at that aspect of it.

7 It was look at regulatory structure and the
8 operations of the ISO and the PX, which were public entities.

9 One of the things that we thought this individual
10 brought to the table was, he was a former regulator in North
11 Carolina. He was actually on the Utilities Commission in North
12 Carolina. So, we thought that was a plus, and we didn't have
13 concerns about the work he had done in the past.

14 CHAIRMAN DUNN: In fact, before we move on,
15 Donna, if I can, let's bring up e11.

16 In fact, it was Mr. Wright who even identified in
17 his application process, so to speak, that he had a potential
18 conflict?

19 MS. HOWLE: That's correct. We had a document
20 asking them to disclose. We interviewed them and asked them to
21 disclose.

22 And then we actually had a document asking them
23 to look at the scope of the audit, scope of the work that we
24 were going to ask them to do, and disclose anything that they
25 considered could be a conflict of interest. And he disclosed
26 that he had worked for Duke Power on issues related to potential
27 deregulation, as you can see.

28 CHAIRMAN DUNN: And in fact, the form that Donna
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1 has now brought up is the nondisclosure statement by Mr. Wright
2 to the State Auditor's Office.

3 MS. HOWLE: This is the Conflict of Interest
4 Statement.

5 CHAIRMAN DUNN: And the box he has checked is:

6 "I have reviewed the scope of
7 work to be performed pursuant to
8 the ..."

9 et cetera, et cetera, and:

10 "have the following potential
11 conflicts ..."

12 et cetera. Then he's written in basically what you've described
13 as his previous work.

14 MS. HOWLE: Right.

15 CHAIRMAN DUNN: In North Carolina. In fact, Duke
16 is based in North Carolina; correct?

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17 MS. HOWLE: That's correct.

18 CHAIRMAN DUNN: Okay. Let's move on and go to
19 the next consultant after Mr. Wright.

20 MS. HOWLE: All right. TXP, Incorporated was the
21 primary contractor. In our discussions with him, he reviewed
22 the scope, and he didn't identify any specific conflicts of
23 interest.

24 CHAIRMAN DUNN: And through the course of his
25 work, did you find that there were any conflicts?

26 MS. HOWLE: His firm does some work -- he's from
27 the State of Texas, and his firm is on retainer with an
28 association of electric companies in Texas.

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1 But again, when we understood the nature of the
2 work, we did not feel that it was a conflict of interest.

3 CHAIRMAN DUNN: With respect to their work, did
4 anybody ever raise an objection?

5 MS. HOWLE: No. No one ever raised an objection
6 related to either Mr. Wright or Mr. Hockenyos, is the individual
7 who was from TXP.

8 MS. REILLY: There wasn't any specific objection.

9 SENATOR BOWEN: Who would raise such an objection?

10 CHAIRMAN DUNN: We're getting there. We're going
11 to get there now.

12 Let's go to the third and final consultant.

13 MS. HOWLE: Okay. The third and final
14 consultants was Pacific Economics Group. And actually, we had
15 more than one individual from that group. The primary
16 individual from that group who started in the beginning of the
17 audit was Mr. Charlie Cicchitti.

18 CHAIRMAN DUNN: That's e10, Donna.

19 In fact, in his Disclosure Statement,

20 Mr. Cicchitti did not disclose any potential conflict.

21 MS. HOWLE: That's the Nondisclosure Statement.

22 CHAIRMAN DUNN: I'm sorry. We're looking for
23 Page Two, I'm sorry. Same document. There.

24 MS. HOWLE: This is the Conflict of Interest
25 Statement that we asked him to sign.

26 No, he did not disclose. However, in the course
27 of interviewing this firm, when we were discussing the scope of
28 what we were going to ask them to do, he did verbally disclose
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1 to us that he had done some work for Duke Energy and actually
2 had testified before FERC.

3 CHAIRMAN DUNN: And when you discussed that with
4 him further, what did you find out about the work he had done
5 for Duke via FERC?

6 MS. HOWLE: The work that he had done for Duke
7 via FERC was very narrow in scope. It was looking at a formula
8 based analysis. It related to the generators. It didn't have
9 anything to do with the ISO and the PX, the structure of the
10 market, which is what we were basically looking at for our
11 consultants to do.

12 CHAIRMAN DUNN: Donna, let's bring up just the
13 first page of e2. Just showing Page One of, I believe, it's
14 30-some odd pages, if I'm not mistaken, of an Affidavit that Mr.
15 Cicchitti filed in front of the Federal Energy Regulatory
16 Commission.

17 Basically within this document, he says under
18 penalty of perjury what he has found with respect to FERC.

19 Is this one of the documents that you ultimately
20 saw as you were exploring what may have been a conflict of
21 interest here?

22 MS. HOWLE: We have that document, yes.

23 CHAIRMAN DUNN: The date of that one is 1999,
24 February 10th, 1999.

25 In fact, Senator Bowen raised the question
26 before. When it came to the work of Mr. Cicchitti or his firm,
27 in fact the State Auditor's Office received -- I don't know
28 whether to characterize it as a concern or an objection to your
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1 retaining their services as a consultant.

2 MS. HOWLE: Yes. We received in the letters we
3 were talking about earlier related to concerns that the market
4 participants had about our access to certain records and the
5 confidentiality requirements, two of the market participants,
6 Duke being one of them, just raised a concern that we had not
7 properly vetted our contractors, and they specifically
8 identified Mr. Cicchitti.

9 CHAIRMAN DUNN: Who was the other on other than
10 Duke?

11 MS. HOWLE: It was Southern Energy.

12 CHAIRMAN DUNN: Now known as Mirant.

13 MS. HOWLE: Oh, I wasn't sure.

14 CHAIRMAN DUNN: They've changed their name to
15 that one.

16 You described what you felt was his work as
17 embraced in this particular document that filed at FERC.
18 Basically it was, he testified via this Affidavit that in his
19 opinion, Duke did not have market power in a given market under
20 the circumstances he was required to examine; correct?

21 MS. HOWLE: That's correct.

22 CHAIRMAN DUNN: And it was your belief that his
23 view on that market power issue did not raise a conflict
24 sufficient to disqualify him as a potential consultant?

25 MS. HOWLE: Based on our discussions with him and

26 subsequent information that he gave to us after Duke raised the
27 concern, we reached the same conclusion, that we did not feel
28 that he had a conflict.

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1 CHAIRMAN DUNN: And we've talked a lot already
2 about your report and how it touches upon the market power
3 issues. Did Mr. Cicchitti have any involvement in that aspect
4 of the state auditor's work?

5 MS. HOWLE: We specifically did not look at the
6 exercise of market power in our audit report. What we were
7 looking at, and what Mr. Cicchitti primarily focused on is the
8 first chapter I was talking about as far as the structure of the
9 market, underscheduling, et cetera.

10 But the exercise of market power was not within
11 the scope of what we looked at. When we talked about market
12 power in the audit report, we're talking about what the market
13 surveillance groups, and did how they identified market power
14 and reported their concerns to FERC.

15 CHAIRMAN DUNN: And did Mr. Cicchitti involve
16 himself in looking at the methodology of those market
17 surveillance folks?

18 MS. HOWLE: Mr. Cicchitti did look at some of
19 those reports that the market surveillance groups put together.

20 CHAIRMAN DUNN: Did he at any time express any
21 criticism of those reports, either conclusions or methodologies?

22 MS. HOWLE: To my knowledge, no.

23 CHAIRMAN DUNN: All right.

24 I want to kind of wrap this line of questioning
25 up with where we began, in that locating and finding consultants
26 that haven't had some relationship with the market participants
27 you found to be extraordinarily difficult?

28 MS. HOWLE: That's correct.

1 CHAIRMAN DUNN: I will add to your conclusion
2 there that all of the rest of us that have looked for
3 consultants that truly have no previous relationship,
4 contractual, consulting, expert, or simply work within those
5 companies, can best be described as challenging if not doggone
6 near the energy crisis, energy challenge. That task is either a
7 challenge or a crisis, whichever one we want to describe.

8 So, we are finding, Ms. Howle, basically the same
9 thing that you encountered as well. In trying to reach out and
10 access those with expertise in this very complicated area, it's
11 really a task of minimizing existing conflicts in a situation
12 where you are incapable of finding individuals who have no
13 conflicts whatsoever to examine this.

14 Of course, we've got the concern -- sorry to be
15 up on the soap box here -- that without that unbiased,
16 nonconflicted individual, we are forever having to determine
17 what sort of bias may be in the information we receive, you
18 receive, any other agency, any other investigation may receive.
19 It's, as we said, difficult at best.

20 Any other questions? Senator Bowen.

21 SENATOR BOWEN: I guess I have some concerns
22 about the fact that Mr. Cicchitti would sign an Affidavit saying
23 that there's no conflict and no potential appearance of lack of
24 independence, when it was his Affidavit at FERC in support of
25 Duke getting market-based rate authority, when he signed that
26 Affidavit at FERC.

27 MS. HOWLE: Well, I think the reason -- and I
28 can't speak for Mr. Cicchitti -- but I think the reason he

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1 checked the box that he checked is because we had already had
2 discussions with him when we interviewed him and talked about

3 the work that he had done. And at that point, we had concluded
4 that we didn't think it was a conflict.

5 So again, I can't speak for him, but I would
6 presume that that's why he felt compelled to check the box that
7 he did.

8 SENATOR BOWEN: When I look at the audit scope
9 and objectives in the letter that Senator Peace wrote, and I
10 don't know if you have it.

11 CHAIRMAN DUNN: For the audit request by Senator
12 Peace, it's e8, Donna.

13 SENATOR BOWEN: It's Page Three of that letter.
14 There's a request to determine how effective the ISO and the PX
15 market surveillance activities are. It's the JLAC hearing.

16 MS. HOWLE: It's the second bullet.

17 SENATOR BOWEN: "Audit Scope and Objectives" is
18 what I'm looking at. It's a discussion of how effective the
19 market surveillance activities are, the extent to which they
20 report quantitative analysis, the methods used in assuring that
21 wholesale prices are a reflection of an adequately competitive
22 market.

23 How can somebody whose previous analysis of
24 whether or not there was market power on behalf of a particular
25 generator, and whose quantitative analysis takes a particular
26 point of view, be expected to independently examine the ISO's
27 market surveillance mechanisms, and whether or not they reflect
28 an adequately competitive market? How can that possibly be an
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1 objective view of the world?

2 MS. HOWLE: Well, I think one of the things that
3 we need to keep in mind is a couple of things.

4 Mr. Cicchitti wasn't the only person looking at
5 this information. We had other consultants. In fact, we had

6 two additional individuals assigned to the audit. And also, we
7 had our staff working on the job.

8 So, we felt that what we were asked to do here,
9 as you say, was to look at the ISO and their market surveillance
10 activities. And Mr. Cicchitti wasn't the only person who was
11 going to evaluate that information. We had other consultants
12 who were economists, and one who was quite a specialist in
13 looking at economic -- econometric models, and all that kind of
14 information.

15 So, we felt we had other individuals who had
16 expertise, and also ourselves in the office, who would be able
17 to mitigate any kind of concern on that part.

18 And also, the work that Mr. Cicchitti did was
19 very narrow in scope, and it was formula-based. It was on, I
20 think, an affiliate of Duke, and looking at whether or not they
21 met a certain threshold.

22 SENATOR BOWEN: I mean, my concern here is that
23 his Affidavit with FERC sets out what I think is a fundamentally
24 flawed view of FERC's determination of whether market power
25 exists, or whether market-based rates are granted. And if those
26 theories, which led to the grant of market power, are carried
27 over into a look at how the ISO assesses market power, we're
28 going to get results that are not reflective of an independent

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1 look at the situation.

2 MS. HOWLE: Well, I think we had an independent
3 look. I think we had the ability with the other consultants on
4 the audit with our staff. In fact, the results in the Audit
5 Report reflect that the methodologies used were appropriate, and
6 the market surveillance groups did identify an exercise of
7 market power.

8 So, I don't think his Affidavit influenced our --

9 our conclusions at all.

10 SENATOR BOWEN: I'm concerned about the fact that
11 he didn't see fit -- in looking at this audit scope, the
12 criteria is appearance of lack of independence, not just actual
13 lack of independence.

14 And it's hard for me to understand how anybody
15 who's filed a 30-page Affidavit with FERC in support of
16 market-based rate authority can, with a straight face, say that
17 there's no appearance of a lack of independence.

18 CHAIRMAN DUNN: Senator Morrow.

19 SENATOR MORROW: Ms. Howle, let me just cut to
20 the chase. What's done is done.

21 MS. HOWLE: Right.

22 SENATOR MORROW: Of course, the investigation is
23 completed. Your report has been filed; it's made public.

24 After going through that whole process, anything
25 come to your attention at all with respect to Mr. Cicchitti,
26 where he has demonstrated, having worked and testified on behalf
27 of Duke in the past, and in the course of this investigation,
28 that he demonstrated any bias toward Duke whatsoever?

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1 MS. HOWLE: Absolutely not.

2 SENATOR MORROW: And looking at the final
3 product, it's hard to find any evidence of bias at all. It
4 would seem to me, if there's any issue at all, it would be the
5 concern that he would be biased in favor of a generator, or Duke
6 in this case, as opposed to prejudice.

7 It seems to me like we're mountain climbing over
8 mole hills here.

9 CHAIRMAN DUNN: Ms. Howle, with your indulgence,
10 I'm going to remain true to my promise to Evelyn and give her
11 about a 10-minute break now.

12 MS. HOWLE: Okay.

13 CHAIRMAN DUNN: I just have a couple follow-up
14 questions. Would you bear with us and stay with us until after
15 the break?

16 MS. HOWLE: Sure.

17 CHAIRMAN DUNN: We're going to do a little shift
18 in the order of witnesses. We are actually going to go right
19 from Ms. Howle to the FERC representative, Mr. Pease, and then
20 this afternoon, we'll be doing our third and fourth witnesses,
21 Loretta Lynch and Mr. Navarro.

22 Let's take a 10-minute break, then we'll be back
23 at about quarter after. We'll only go for about 45 minutes, and
24 then we'll take that lunch break that I had discussed in the
25 earlier comments. Break for 10 minutes.

26 [Thereupon a brief recess
27 was taken.]

28 CHAIRMAN DUNN: Let's reconvene here. Just a few
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1 follow-up questions. I know we keep promising, Ms. Howle, and
2 it turns out to be another hour along the way.

3 Again, for clarification, we've adjusted schedule
4 one more time. As soon as we finish with the State Auditor,
5 we're going to go to the FERC representative, Mr. Pease. And
6 then this afternoon, we will do the testimony of the President
7 of the PUC, Loretta Lynch. And again, the afternoon session
8 will start at 1:30, for those who are watching the time clock.

9 Just prior to the break, there was a lot of
10 discussion about Mr. Cicchitti, about a potential conflict of
11 interest, and its impact potentially on the State Auditor's
12 Report. Both Senator Bowen and Senator Morrow had some
13 questions.

14 I know I asked you this question before. I just
Page 63

15 want to make sure that there's no ambiguity here.

16 Whether there was a conflict or not a conflict
17 with any of your consultants, the work of your office and your
18 consultants in examining the methodology and conclusions of the
19 market surveillance entities in the ISO and the PX found no
20 criticism or concerns about either the methodology or their
21 conclusions.

22 MS. HOWLE: That's correct.

23 CHAIRMAN DUNN: Do you have any disagreement that
24 basically their conclusions have been that there is an existence
25 of market power with some of the market participants, and that
26 market power has been exercised through a variety of ways on the
27 California wholesale electricity market?

28 MS. HOWLE: I would agree with that

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1 characterization, yes.

2 CHAIRMAN DUNN: Just a couple loose end type
3 questions. Donna, while we're doing that, if you could bring up
4 Page 88 of State Auditor's Report.

5 The very beginning of your report, you note that
6 proponents of deregulation promised competition that would lower
7 the retail prices. I mean, that was the whole premise.

8 MS. HOWLE: That was exactly the premise
9 behind it.

10 CHAIRMAN DUNN: In looking at the findings of the
11 market surveillance entities within the ISO and the PX, would
12 you agree that the behavior that they discovered actually had
13 the opposite impact on prices.

14 MS. HOWLE: Based on the reviews that we looked
15 at, based on the work that we did, yes, I would agree with that.

16 CHAIRMAN DUNN: And in your opinion, is there any
17 further work that you believe is necessary from your perspective

18 to further examine this particular issue?

19 Again, I know we're focused in on just the ISO
20 and the PX, but any further work? Did you short circuit the
21 audit at all? Felt it was pretty complete?

22 MS. HOWLE: No, we feel the audit was complete.

23 CHAIRMAN DUNN: Have you received any criticism
24 of the Audit Report or its conclusions from any segment of the
25 market participants, the generators, the traders, and even
26 outside the market, such as academia? Anybody that's been
27 critical of your findings within your report?

28 MS. HOWLE: To my knowledge, no. We have not

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1 received any specific complaints about the conclusions that we
2 reached.

3 CHAIRMAN DUNN: Nobody's written you a letter
4 saying, doggone it, that has got to be the most ridiculous
5 conclusion? And nobody's accused you of voodoo economics?

6 MS. HOWLE: No, they have not.

7 CHAIRMAN DUNN: In fact, your report's been held
8 up by somebody as clearing their name?

9 MS. HOWLE: Unfortunately, we can't control how
10 people use our reports. And as I said earlier, that was not a
11 fair characterization of our report.

12 CHAIRMAN DUNN: One last question, Ms. Howle.
13 I've had Donna put up Page 88 from your report. It's Table Ten
14 that's up there.

15 If you would, Donna, I want you to zero in on the
16 one that starts, "Opportunity to exercise market power."

17 As she's doing that, this is referred to as Table
18 Ten. It's called, "Identified Causes of the California Energy
19 Crisis."

20 I know your report was issued about two months

21 ago, and two months have gone by. A lot has happened in those
22 two months.

23 Has there been anything that's occurred that has
24 caused you to question any of the identified causes in Table
25 Ten?

26 MS. HOWLE: No.

27 CHAIRMAN DUNN: In particular, I want you to look
28 at the section that Donna has highlighted, entitled,

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1 "Opportunity to Exercise Market Power through," and then there's
2 a list of them.

3 Very quickly for us, just tell us what each one
4 of those are. I know you've already talked about some of them,
5 but just very quickly, if you would.

6 MS. HOWLE: Right. Out of market purchases, of
7 course, is the -- the leakage, as we called it, to get the price
8 higher. Limited number of generators, as Senator Bowen said.
9 There's a limited number of generators; there's a limited number
10 of purchasers.

11 Restraints on forward contracting. We talked a
12 little bit about that, where the PUC had made some changes, but
13 they limited the amount of megawatts that could be purchased.
14 So, there wasn't the ability to get the price down by entering
15 into forward contracts.

16 Withholding of generation, as we talked a little
17 bit earlier, the underscheduling, and withholding that
18 generation to bump up the price.

19 Local market power caused by restricted
20 transmission. Transmission capacity, we really didn't get into
21 a discussion of transmission capacity in our report. Other
22 reports have identified that there are some problems in certain
23 portions of the state related to transmission.

24 Generator withholding caused by ISO out-of-market
25 payment schedule. I'm not exactly, sure but I think this is
26 where, if the ISO purchases out-of-market, even if there's a
27 cap, the purchases are not subject to that cap, so you're
28 basically paying any price.

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1 And generators failing to respond to ISO orders
2 to dispatch energy, I don't know exactly what that's referring
3 to. I know that the ISO -- MSC is the Market Surveillance
4 Committee must have identified a concern there.

5 CHAIRMAN DUNN: And the graph after each one
6 those entries, what is that?

7 MS. HOWLE: The dots are identifying -- what we
8 do when we conduct audits is, of course, we want to see if
9 anybody else has done anything in the areas that we've been
10 looking at. So, these different columns are groups that have
11 done work, and what the dots are showing is, is this something
12 that just one group found, or are we seeing the same concern
13 being raised by lots of different entities?

14 So, when you see the dots across the board,
15 you're seeing at least two, three, four different entities
16 identifying the same problem.

17 CHAIRMAN DUNN: And going across, it's ISO, which
18 we all ready know. And the ISO-MS refers to the Market
19 Surveillance Committee?

20 MS. HOWLE: Right, and then the Power Exchange is
21 their monitoring group. CPUC is a report that was done by the
22 PUC as well as an individual from the Oversight Board, and then
23 FERC, of course, is the Federal Energy Regulatory Commission.

24 CHAIRMAN DUNN: And the last column?

25 MS. HOWLE: The last column is the type of
26 problem. We had a legend in the report that identifies. Number

27 one would be fundamental market structure problems. Number two,
28 operational problems. And number three is competitive market

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1 forces.

2 CHAIRMAN DUNN: Any further questions for
3 Ms. Howle? Hearing none, I think we've actually come to the
4 end, Ms. Howle.

5 I also want to extend my sincere gratitude to
6 you. You've been very patient. We expected to get to you the
7 very first hearing in Sacramento some time ago. We didn't. We
8 didn't make it the second time around, and we made you fly all
9 the way down here.

10 And we appreciate it very, very much, and
11 appreciate your testimony today. It helps tremendously as we
12 gain a further understanding of what may have occurred, giving
13 rise to the California energy crisis.

14 Thank you very, very much.

15 MS. HOWLE: I thank you.

16 CHAIRMAN DUNN: Let's go immediately, as they're
17 wrapping up, to our next witness, and that is Mr. Robert Pease
18 from the Federal Energy Regulatory Commission.

19 Erik, your duty.

20 MR. LANGE: Mr. Pease, could you stand, please.
21 Raise your right hand and state your name for the
22 record.

23 MR. PEASE: Robert Pease.

24 [Thereupon the witness,
25 ROBERT PEASE, swore to tell
26 the truth, the whole truth,
27 and nothing but the truth.]

28 MR. LANGE: You may be seated.

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1 CHAIRMAN DUNN: Mr. Pease, what we intend to do
2 is, we've got about 20, 25 minutes before we have to break.
3 We're just going to try to cover some foundational material and
4 get that out of the way. Then, when we're back for the
5 afternoon session, get into kind of the heart and soul, so to
6 speak, of the testimony with respect to FERC.

7 So, can you tell us, Mr. Pease, a little bit
8 about your own personal and professional history, your
9 involvement at FERC, and also in some detail if you would, what
10 is the role of FERC, its jurisdictional boundaries, and how it
11 is involved with the energy market.

12 MR. PEASE: My name is Robert Pease. I'm the
13 Managing Attorney of the Market Oversight and Enforcement
14 Section of the Office of the General Counsel at FERC.

15 I've been at FERC for 13 years. I'm essentially
16 a trial attorney. I'm not used to being on this side of the
17 table. I'm used to asking the questions, so I will try today to
18 answer as best I can all of the questions that you are asking
19 today.

20 Our section is the section that is primarily
21 responsible for conducting investigations of wrong doing, as
22 well as being one of the groups within FERC that monitors energy
23 markets for the agency.

24 I have a prepared text which I'll give in a few
25 minutes, but let me tell you a little bit about FERC.

26 FERC is an agency of approximately 1200
27 employees. We regulate on the electricity side. We regulate
28 the sales on the wholesale market, and the sales for resale.

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1 Essentially, what we're talking about here are
2 the sales from -- in the context of California, the independent
3 power marketers, to the utilities, the three main utilities here

4 in California.

5 And what we do is, we also regulate the rates for
6 the transmission service.

7 It's important to note what we do not regulate.
8 What we do not regulate on the electric side, unlike the gas,
9 which I'll talk about in a moment, is the siting of generation
10 and transmission facilities. And by generation, I'm talking
11 power plants. That's under the state authority, as well as the
12 siting of electric transmission lines is under state authority.

13 There are proposals before Congress right now as
14 part of President Bush's energy speech the other day, yesterday,
15 I believe, to give FERC some of those powers, but we do not have
16 them today.

17 On the natural gas side, we also regulate sales
18 for resale. But we do have considerable authority over the
19 construction of pipelines and their siting, including giving
20 them eminent domain authority to the pipelines to be able to
21 construct the pipelines all over the country.

22 CHAIRMAN DUNN: I know that you have heard
23 already this morning, and we've heard from past witnesses, about
24 certain confidentiality provisions that emanate from the FERC
25 tariffs.

26 Can you please describe those for me?

27 MR. PEASE: Essentially, the California ISO is
28 defined under the FERC statute as a public utility. So

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1 therefore, the California ISO falls under FERC -- exclusive FERC
2 jurisdiction.

3 And they have tariffs. The tariffs essentially
4 are the rules by which the ISO is going to operate. That's all
5 a tariff is. Now, there are many different rules that they
6 have, but they file those with the Commission, and then the

7 Commission approves them, and that becomes the rules by which
8 the ISO operates.

9 One of the provisions which is in the Federal
10 Power Act, and in the Commission's regulations, and in the
11 FERC-approved tariffs of the ISO, are the confidentiality
12 provisions. What they essentially say is, the bid data that is
13 being given, among other things, to the California ISO that
14 would not be given to the California ISO by the generators but
15 for the ISO running the various -- running the energy markets
16 that it does, that information is to be kept confidential for a
17 six-month period. After that six-month period is over, that
18 information is available from the ISO.

19 Most of that information is not filed directly
20 with FERC, but instead it is filed with the ISO, and the ISO
21 market monitoring units review it, as was discussed by the
22 Auditor earlier.

23 CHAIRMAN DUNN: You mentioned that most of it's
24 filed with the ISO.

25 I assume some is filed with FERC?

26 MR. PEASE: It depends on the specific instance.
27 If they're requesting certain authority from FERC, then that
28 might be material they might submit to FERC.

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1 But most of the information that was discussed
2 this morning in terms of actual bids that are going on a
3 day-to-day basis to the power markets, the ISO and earlier the
4 PX before it was dissolved, those would be almost exclusively
5 with the ISO.

6 CHAIRMAN DUNN: The purpose for my question is,
7 to the best of your knowledge, would there be any confidential
8 data, confidential as you just described it, filed with FERC by
9 the market participants that wouldn't be filed at the ISO?

10 MR. PEASE: Yes.

11 CHAIRMAN DUNN: Describe for me what would be
12 filed at FERC but not at the ISO?

13 MR. PEASE: Let me clarify the word "file".
14 Provided to FERC would be a better description, and the only
15 reason I say that is to make sure -- we're dealing with words of
16 art.

17 Filed would be documents that would be given to
18 FERC as part of a public record, as opposed to provided to FERC,
19 which may be on any context, including filed.

20 I realize this is very technical and rather
21 boring.

22 But also, where my section engages in
23 investigations of wrong doing, and information would be given
24 directly to us, and would be given confidential treatment under
25 our regulations.

26 For example, one of the cases that I'll talk
27 about in a few minutes in my prepared text and question is the
28 AES Williams case, where the Commission recently approved a

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1 settlement providing for \$8 million to be paid back to the ISO
2 as refunds for withholding of power. And in that situation,
3 certainly information was given directly to my section, and it
4 was given to us on a confidential basis.

5 CHAIRMAN DUNN: What I want to do is, I want to
6 explore the confidentiality side, and then go to your prepared
7 comments, Mr. Pease.

8 So, there is data that could be provided to FERC
9 that is not provided to the ISO; correct?

10 MR. PEASE: Yes, but we're talking extremely
11 small and case specific --

12 CHAIRMAN DUNN: That's my question.

13 MR. PEASE: -- amount of information. You're not
14 talking about -- if you're talking about, you know, a hundred
15 percent of the information, I would say 99-point-something
16 percent would be with the ISO, if not 99.8 percent.

17 CHAIRMAN DUNN: Understood.

18 MR. PEASE: A very small percentage.

19 CHAIRMAN DUNN: We appreciate that.

20 You mentioned the six-month rule, that that
21 bidding data you described is covered by the FERC tariff
22 confidentiality provisions for six months.

23 MR. PEASE: That's correct.

24 CHAIRMAN DUNN: We're now in May. So, anything
25 up through November of last year is no longer covered by the
26 FERC confidentiality provisions?

27 MR. PEASE: At least in terms of the tariff
28 itself. There may be situations where generators may say that
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1 this reveals trade secrets, or whatever. Those would be ruled
2 on a case-by-case basis.

3 CHAIRMAN DUNN: Okay.

4 MR. PEASE: As a general matter, the answer to
5 your question is, the information is no longer confidential.

6 CHAIRMAN DUNN: In other words, and I'm sorry to
7 drag everybody into the lawyers discussion here, once we're
8 outside of the six-month FERC confidentiality period, anyone who
9 has provided data, say, to the ISO, must rely upon the normal
10 confidentiality provisions provided in law, such as trade
11 secrets, for example?

12 MR. PEASE: I think that's a fair
13 characterization.

14 CHAIRMAN DUNN: And so, unless it was a trade
15 secret, if I asked for something from the ISO that was before

16 November of last year, if it's not a trade secret or other
17 identified confidentiality, subject to some other
18 confidentiality, it should be provided, to the best of your
19 knowledge?

20 MR. PEASE: That is my understanding of how those
21 rules apply.

22 CHAIRMAN DUNN: Why the six-month rule?

23 MR. PEASE: Because the Commission said in its
24 orders that this information, that the bid data, for example,
25 that will given to the ISO, could reveal the strategies of a
26 particular company which could cause that company
27 anti-competitive harm in relation to another competing
28 generator.

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1 So for example, if Company A is engaging in
2 certain activity, they don't want Company B to know about it so
3 they could take advantage of what they may perceive as a
4 weakness, or whatever, of the first company.

5 So, we try to protect that very highly
6 confidential information at least in terms of real time by
7 keeping it confidential for that six-month period.

8 CHAIRMAN DUNN: Would you agree that if it could
9 be shown that in fact the market participants already had that
10 data, that then there is no reason for the six-month rule?

11 MR. PEASE: I think I'd leave that to the
12 Commission to answer that question.

13 CHAIRMAN DUNN: Probably a wise answer.

14 Senator Bowen, then Senator Escutia.

15 SENATOR BOWEN: Thank you.

16 I appreciate the experience you face being on
17 that side. I've had it happen as an attorney too, and it's a
18 very strange experience.

19 MR. PEASE: It certainly is different.

20 SENATOR BOWEN: How are the consumers of
21 electricity protected? What's the balance between the
22 confidentiality and the protections of proprietary information
23 in the market, and how the FERC's rules protect consumers during
24 the period during which that information cannot be reviewed by
25 anyone on behalf of consumer groups?

26 MR. PEASE: The ironic thing that has happened,
27 in my view, and not the Commission's view.

28 I should disclose at the beginning that I'm here
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1 as a Commission staff witness and don't speak on behalf of any
2 particular Commissioner or the Commission itself.

3 What we've had with the Internet and the
4 explosion of making public information, as the State Auditor
5 discussed this morning, what you end up having is a significant
6 amount of information that may not have been disclosed before --
7 such as the needs of the ISO, and the needs of California for a
8 certain amount of power that they will need to produce on a
9 particular day -- is now all public. Whereas, that information
10 really was not public in the past. So, a lot of information has
11 become public, and then, what is not public are the individual
12 companies' proprietary information.

13 How that would relate to the consumers, the
14 consumers are protected in a number of ways. The state
15 commissions are empowered specifically to protect the retail
16 customers, which I think is the thrust of your question. And
17 FERC's job is to make sure that the prices on the wholesale
18 market are just as reasonable.

19 SENATOR BOWEN: Actually, I'm speaking on behalf
20 both of retail customers and wholesale customers.

21 One of our wholesale customers, as you know, is

22 in bankruptcy; another is insolvent. So, we're also looking at
23 how we deal with the wholesale customers, and ultimately, what
24 the retail customers pay is 100 percent a function of what the
25 wholesale customers pay.

26 MR. PEASE: Sure.

27 What the Commission has tried to do in a number
28 of recent orders is try to get the markets back to being market
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1 driven as opposed to -- dysfunction may be too strong of a
2 word -- but the markets weren't working before. We had
3 numerous price spikes. We had numerous instances that were
4 testified this morning about situations where the prices in the
5 wholesale market have escalated dramatically.

6 As I'll explain, what FERC tried to do in some
7 recent orders is try to open up those markets, and in particular
8 where we're having situations where there's a Stage One or where
9 power reserves are down to seven-and-a-half percent, where we
10 have significantly changed the rules on how the wholesale prices
11 will be determined in terms of market clearing prices, which
12 will protect the consumers from the price gauging.

13 SENATOR BOWEN: Although, you know we had power
14 at \$1900 a megawatt hour last week; right?

15 MR. PEASE: Yes.

16 SENATOR BOWEN: Is that a just and reasonable
17 wholesale price?

18 MR. PEASE: It certainly strikes me personally as
19 something that is quite on the high side, to put it mildly.

20 SENATOR BOWEN: So, although I noted in a memo
21 that Southern filed with the ISO in 1999, that they stated that
22 they were open to price caps on the order of \$10,000 a megawatt
23 hour.

24 I presume that that wouldn't be deemed to be a

25 just and reasonable wholesale rate?

26 MR. PEASE: The Commission certainly hasn't gone
27 in that direction, no.

28 SENATOR BOWEN: I'll wait, but I do want to have
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1 a discussion about this last order that focuses on the shortage
2 stages, because we were not in a shortage situation last week
3 when we hit \$1900 a megawatt hour.

4 MR. PEASE: I understand that.

5 CHAIRMAN DUNN: Senator Escutia.

6 SENATOR ESCUTIA: Thank you very much.

7 I have two lines of questioning. The first one
8 with regard to what happens after the six months expire on this
9 cloak of confidentiality that lasts for six months.

10 And my other question deals more specifically
11 with the consent agreement with AES Williams, and it has some
12 nondisclosure sections there. But I think that second line of
13 questioning can wait until, I assume, Mr. Chair, we're going to
14 have discussions over this consent decree?

15 CHAIRMAN DUNN: Yes.

16 SENATOR ESCUTIA: All right, then I will withhold
17 it, that part, until that discussion.

18 But for right now, just for my edification, over
19 the issue of this FERC tariff between ISO and FERC, specifically
20 the confidentiality provisions.

21 You have stated that the information is
22 confidential for six months. And that after six months, the
23 information is available from ISO; is that correct?

24 MR. PEASE: Yes.

25 SENATOR ESCUTIA: My question is, what type of
26 information is available? Who would have standing to request
27 that information? And what is the process? What's the

28 procedure for requesting that information?

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1 MR. PEASE: I think under the FERC tariff that's
2 approved, for example, this committee could ask directly the ISO
3 for the information. Unless, as Senator Dunn and I discussed,
4 it's protected for some other reason, the ISO can make that
5 information public by turning it over to you, putting it on
6 their web site.

7 SENATOR ESCUTIA: So, anyone would have standing,
8 then?

9 MR. PEASE: The tariff just says it's
10 confidential for six months. I don't think it addresses
11 anything further than that, or restricts access to it beyond
12 that period.

13 SENATOR ESCUTIA: Is there any time by which we
14 have to assert this process in terms of us requesting this
15 information, any time limits?

16 MR. PEASE: No.

17 SENATOR ESCUTIA: Obviously, we will do some type
18 of a filing before ISO, requesting these documents. Then it's
19 up to ISO to claim certain privileges?

20 MR. PEASE: The ISO, I believe, is required --
21 and I'm not sure if it applies to the six-month period or not --
22 if a request comes to the ISO, the ISO is required by its tariff
23 or its operating agreement with its members, to notify them of
24 any requests for information. Then they, in turn, can voice
25 objection to the release of that information.

26 SENATOR ESCUTIA: Wouldn't a claim on the part
27 of, say, the State of California, this committee specifically,
28 that the information that we're seeking, you know, in order to

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1 perhaps rebut claims of confidentiality, couldn't we claim that

2 perhaps the State of California has a great public interest in
3 making sure this information is disclosed? Wouldn't that
4 outweigh whatever claims of confidentiality the other people
5 might have?

6 MR. PEASE: I don't want to speculate on what the
7 -- how court would rule on a particular instance of
8 confidentiality, but in general, the information is available.

9 SENATOR ESCUTIA: Now, if say this committee were
10 to be unsuccessful in getting that information from the ISO as a
11 result of these claims of confidentiality being asserted, and
12 obviously this is happening after the six-month span, what's our
13 redress? Where do we go? Do we go into court, you know, to
14 have a judge determine whether the claims confidentiality are
15 legitimate or not?

16 MR. PEASE: I think that's the way it would go.
17 You could make a FOIA request, Freedom of Information Act
18 request with the agency to be able to turn over that
19 information.

20 But let me stress that the reason, the rationale
21 the Commission gave for this bid data is as revealing certain
22 strategies or certain information. But is only time sensitive
23 information. Once that period of time has expired, and most of
24 the discussion we've had really is on bid data, this bid data
25 would be made public, by and large.

26 I can't think of examples --

27 SENATOR ESCUTIA: So, they wouldn't be able to
28 claim a proprietary interest over that, because you indicated
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1 that it's time sensitive, so time has expired.

2 MR. PEASE: That's my basic point. In general,
3 no, I don't think they'd be able to make a convincing claim that
4 that information, bid data, for example, couldn't be made

5 public.

6 But I don't want to rule out, you know, any
7 possible situation where they wouldn't make such a claim. But I
8 don't see that as being the norm or covering any significant
9 percentage of the data.

10 SENATOR ESCUTIA: You mentioned Freedom of
11 Information Act. I'm not an expert in those type of provisions.

12 Is the information under FOIA Presumed to be open
13 unless certain, you know, elements of confidentiality apply?

14 MR. PEASE: That's exactly correct.

15 SENATOR ESCUTIA: Can you identify what are those
16 claims of confidentiality that might be triggered pursuant to a
17 FOIA request?

18 MR. PEASE: I am also not an expert on FOIA, but
19 some of the ones that we have touched on were the trade secrets,
20 proprietary business information.

21 There are very limited reasons under FOIA that
22 would be applicable here.

23 SENATOR ESCUTIA: I assume that a FOIA request,
24 is it time sensitive? Does it have some time of absolute
25 drop-dead deadline by which an agency's got to respond pursuant
26 to a FOIA request?

27 MR. PEASE: That the agency must respond?

28 SENATOR ESCUTIA: To a FOIA request.

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1 MR. PEASE: I don't know of any specific
2 deadline. My agency's -- but again, I don't know for certain.
3 I'm not an expert. My agency's policy is 30 days. My agency's
4 policy is that we attempt to answer all FOIA requests within 30
5 days.

6 SENATOR ESCUTIA: In addition to FOIA
7 regulations, you also have Commission regulations that deal with

8 information and confidentiality claims; correct?

9 MR. PEASE: That is correct.

10 SENATOR ESCUTIA: Now, can you take me very
11 briefly along those Commission regulations as to what are the
12 issues of confidentiality, and how do they compare or contrast?
13 Are they similar or dissimilar from FOIA?

14 MR. PEASE: There are two main provisions in the
15 Commission's regulations. The first -- the Commission's
16 regulations, by the way, are located at 18 CFR. Code 18 of the
17 Code of Federal Regulation. That's what CFR stands for.

18 SENATOR ESCUTIA: Yes, I have that here.

19 MR. PEASE: If you look at Section 388.112, that
20 is the provision that applies to the discussion related to what
21 Senator Dunn and I had earlier in terms of documents that are
22 filed with the Commission.

23 If someone files a document with the Commission
24 and requests confidential treatment of that information, they
25 would file it with a cover letter saying, "We think this
26 information is confidential. Here is why we think it is
27 confidential, and we ask the Commission to keep this portion
28 from public view."

9

1 And then, they also have to file a redacted
2 version of their document, and the redacted version is made
3 public immediately.

4 Anyone can challenge that claim of disclosure,
5 and then the Commission would review it. And the Commission
6 would give the entity that claimed that the information should
7 be treated confidentially five-days' notice in which to respond
8 as to why it should remain confidential when we have a request
9 for the public disclosure of that information. Then the
10 Commission would rule on that.

14 only says it must be kept for six months.

15 SENATOR BOWEN: Thank you.

16 CHAIRMAN DUNN: I just want to do a couple
17 follow-ups. I know this is pretty dry, part of it, but as you
18 well know, Mr. Pease, a very critical one for us to gain access
19 to all the information we believe is necessary to complete our
20 investigation in the coming weeks.

21 You've mentioned that within that six-month
22 provision, the confidentiality applies to bid data.

23 Is there anything else that it applies to in
24 broad categories, other than bid data, to your knowledge?

25 MR. PEASE: Not to my knowledge, but there may be
26 other areas, but not to my knowledge.

27 I would like to say one thing. The tariff, which
28 is, I think, an operating agreement, which is essentially

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1 incorporated within the tariff of the ISO, also provides that
2 the ISO cannot turn over that data directly to FERC prior to
3 notifying the members. So, the situation also applies to us,
4 the way the tariff has been -- currently reads.

5 CHAIRMAN DUNN: Are you aware of any situation in
6 which a market participant objected to data being turned over
7 from the ISO to FERC?

8 MR. PEASE: They haven't quite gone that far.

9 CHAIRMAN DUNN: Love to see that situation.

10 MR. PEASE: But there have been instances where
11 they've come in and emphasized the confidential nature of it.
12 There have been generators who have requested that we enter into
13 protective orders, which we have refused to do, and other means,
14 because they're very afraid that this information could be made
15 public.

16 And it's not an idle fear. There are recent

17 articles, not directly related to this bid data, where
 18 information was released. And the El Paso case that's in
 19 hearing right now before an administrative law judge at the
 20 Commission, and very sensitive company information was leaked to
 21 the New York Times and the Wall Street Journal. So, their fears
 22 are not idle.

23 And the fears of confidentiality as a whole --
 24 it's extremely frustrating to be on the other side of a
 25 confidentiality situation, where you are trying to get the
 26 data.

27 But where we discussed a few minutes ago, Section
 28 1(b) of the Commission's regulations, we keep secret even the
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1 fact that we're investigating a particular company, and for good
 2 reason. There have been instances where, once the Commission
 3 makes public that we are investigating someone -- and
 4 investigating does not mean that the company has necessarily
 5 broken the law -- but the release of the information that we are
 6 investigating someone can have a profound effect on a company's
 7 stock, among other possible ramifications.

8 So, before the Commission takes action, we want
 9 to be sure that we are not trampling on other's rights in
 10 situations where there may not be wrong doing.

11 You're primarily focused here on situations where
 12 there may well be wrong doing, and expressing frustration
 13 getting the information, and I can sympathize with that.

14 CHAIRMAN DUNN: Frustration is one word that we
 15 could apply to it. There's a few others.

16 I want you to be, Mr. Pease, very specific in
 17 responding to this question.

18 How is the phrase, "bid data," which falls under
 19 the six-month prohibition, defined?

20 MR. PEASE: I don't know if there is a specific
21 definition for it. My understanding of it is the price that the
22 generators are willing to bid their power into the markets for
23 sale.

24 CHAIRMAN DUNN: Okay, but the data that's
25 provided, to your knowledge, to the ISO is much broader than
26 just that. I don't mean to use the word "just," but is beyond
27 that definition?

28 MR. PEASE: That's correct.

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1 CHAIRMAN DUNN: So that at least in your
2 interpretation of the FERC tariff prohibitions, it would apply
3 to only that bidding data you've just described?

4 MR. PEASE: I don't think that's quite fair. I
5 think it would apply to all of the information provided. I
6 don't know what the specific definition would be for bid data.

7 CHAIRMAN DUNN: Where could I go to find that?
8 And I'm not trying to throw a curve ball at you, Mr. Pease.
9 Here's the reason I'm asking the question.

10 We are, this committee, is currently engaged in a
11 disagreement over confidentiality and its breadth as determined
12 by the FERC tariffs and what should be available to us without
13 the confidentiality provisions applying.

14 It's important for us to be able to come to an
15 agreement, not this committee and you, but ourselves and the
16 market participants, as to the definition of bid data and what's
17 truly covered by the FERC tariff, and what should be, in our
18 view, provided to us without the FERC tariff protection.

19 MR. PEASE: I think that's a fair question.

20 My suggestion would be that that is something the
21 committee may want to bring specifically to the Commission's
22 attention, and ask the Commission specifically to define the

23 various provisions so that there won't be ambiguity between and
24 among the various groups that want to get this data.

25 There is no request that I know of right now
26 before the Commission.

27 CHAIRMAN DUNN: How long would that take? Can we
28 expedite it?

9

1 MR. PEASE: Certainly, yes, you can. You can
2 request expedited treatment.

3 The Commission has -- I can promise you that the
4 Commission would give it a high degree of attention. There is
5 no statutory requirement as to time on when they would have to
6 answer it. But we've been going very quickly on everything
7 related to California.

8 CHAIRMAN DUNN: You might get some disagreements
9 from some individuals on this committee, but we'll leave that
10 one.

11 Let me ask one very specific question on other
12 documents. Staff reports by individual staff members to
13 individual Commission members that do not include bid data would
14 be outside that FERC confidentiality tariff; correct?

15 MR. PEASE: It depends on what the reports would
16 be.

17 CHAIRMAN DUNN: I understand. If the report does
18 not have any of the bid information that we would all agree is
19 covered by the tariff, are you aware of any other provisions
20 that would preclude the production of staff reports?

21 MR. PEASE: Yes.

22 CHAIRMAN DUNN: What else?

23 MR. PEASE: Deliberative process provision, which
24 can be waived by the agency.

25 CHAIRMAN DUNN: The agency as a whole, not an

26 individual Commissioner?

27 MR. PEASE: That's correct.

28 That deliberative process is a privilege that₉

1 protects agencies and protects, for example, your committee in
2 its deliberations, so that your committee can have an open and
3 frank discussion of various issues without the public knowing
4 everything that is going on behind either -- all of the exchange
5 of information is not released to the public. And that's the
6 essence of the deliberative process, privilege.

7 CHAIRMAN DUNN: If in fact we want to make a
8 request for such information, it's that same process of make
9 application to FERC, and it will act on it in due course?

10 MR. PEASE: Yes, you could ask for that
11 information under the Freedom of Information Act.

12 CHAIRMAN DUNN: And if denied, then we have the
13 normal routes of recourse?

14 MR. PEASE: That's correct.

15 CHAIRMAN DUNN: Committee, are there any other
16 questions? Senator Bowen.

17 SENATOR BOWEN: I do have one question, and it's
18 really just to help me understand.

19 What is the statutory basis for the FERC tariffs
20 that provide for confidentiality?

21 MR. PEASE: I'm not sure what I can add to what I
22 haven't said in terms of proprietary information and of the
23 like. That's the basis that the Commission has articulated for
24 keeping information confidential in this instance on a
25 particular set of data.

26 SENATOR BOWEN: Is there something in the Federal
27 Power Act that allows FERC to adopt a tariff that includes
28 confidentiality provisions?

1 MR. PEASE: Just the general provisions that FERC
2 has authorized to approve the conditions under which the
3 utilities would be operating. I don't know of a specific
4 provision in the Federal Power Act that deals exclusively with
5 confidentiality.

6 CHAIRMAN DUNN: Mr. Pease, we're past the noon
7 hour, and I know we haven't even gotten to your prepared
8 comments.

9 We're going to take a lunch break at this point
10 in time. Again, my apologies to all the members of the public
11 that are here. We will be back and reconvene at 1:30, in about
12 an hour and 20 minutes, right back here.

13 We are recessed for this lunch break.

14 [Thereupon the luncheon
15 recess was taken.]

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6 back up then for those who were not here, and identify myself as
7 Robert Pease. I'm the Managing Attorney of the Market Oversight
8 and Enforcement Section of the Office of the General Counsel at
9 the Federal Energy Regulatory Commission, or FERC.

10 I appear here today as a Commission staff witness
11 and do not speak on behalf of the Commission or any
12 Commissioner.

13 Now I'd like to describe a few of the more recent
14 orders that the Commission has issued.

15 The two orders in March, the Commission took
16 strong action to mitigate prices in California's electricity
17 markets for January and February of this year. In these orders,
18 the Commission identified many transactions that warranted
19 further investigation. The Commission ordered sellers to refund
20 a total of \$124 million, or provide additional justification for
21 their prices. These two orders are currently pending on
22 rehearing before the Commission.

23 Rehearing is simply a second review by the
24 Commission of the orders. And after that is completed, that
25 should be the end of Commission action, although someone could
26 take that matter to court.

27 On March 14th, the Commission ordered two
28 companies, AES Southland and Williams Energy Marketing and 10

1 Trading to justify the duration of outages at AES's California
2 generating facilities at Alamos and Huntington Beach. Those
3 two plants are owned by AES, but the power marketed by
4 Williams.

5 The outages forced the California ISO to purchase
6 more expensive power from the companies' other generating
7 facilities. The period we're dealing with here is the time
8 period, a two week period, from April to May of 2000. And

9 during that period, as I said, the California ISO had to buy
10 power from higher priced units owned by AES and marketed by
11 Williams for reliability purposes, because the lower priced
12 units were out of service.

13 On April 30th, the Commission approved a
14 settlement calling for refunds of \$8 million to the California
15 ISO for the overpayments. The settlement also places a one-year
16 condition on the market-based rate authority, requiring Williams
17 to bear the risk if any of these reliability must-run units are
18 unavailable at any time during that year.

19 On March 28th, the Commission addressed a
20 complaint brought by the California Public Utilities Commission
21 under Section 5 of the Natural Gas Act against the pipeline
22 company El Paso and its marketing affiliate. While the
23 Commission found that the allegations that the bidding process
24 was unfair were unsupported, FERC ordered a hearing on whether
25 the pipeline and its affiliate has market power, and if so,
26 whether it used that power to drive up natural gas prices at the
27 California border.

28 That case is, as we speak, before an

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1 administrative law judge on an expedited hearing, with the
2 decision expected by the ALJ no later than June 30th of this
3 year.

4 On April 26th, the Commission adopted a new
5 market monitoring and mitigation plan for California. The plan
6 provides a number of related measures intended to help
7 California's electricity market, and to offer immediate relief
8 to consumers, including price mitigation, a demand response
9 mechanism, coordination of planned outages, and steps to prevent
10 economic or physical withholding of power.

11 Starting in late May, a market driven price for

12 real-time electricity will be determined each day by a formula
13 based on the market cost for electricity inputs, the natural gas
14 and emission allowances, and the fuel usage ratio, or heat rate,
15 and an emission rate for the least efficient generator needed to
16 meet demand that day.

17 All California generators bidding at or below
18 this market driven price will be paid the market price. Any
19 California generator bidding above this price and selected to
20 run by the ISO will be paid its price, but it will be subject to
21 refund and justification, and its bid may not, unlike the way
22 the previous market worked, it will not raise the market price.
23 This new price mitigation plan applies when California reaches a
24 Stage One emergency. That is, when generators are at or below
25 seven-and-a-half percent.

26 This threshold of Stage One is based on the fact
27 that the critical problem is a lack of supply, and a Stage One
28 emergency signals when supply is nearing the point of being

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1 insufficient.

2 The order also increases the coordination and
3 control of outages by the ISO. It requires sellers with
4 participating generating agreements and others who are selling
5 into California to offer all of their available power in real
6 time. This order will help ensure that customers are adequately
7 protected against unjust and unreasonable rates, while also
8 providing a market-oriented price for the California generators.

9 The Commission is also attempting to move
10 obstacles to increase electric generation and natural gas supply
11 in the western United States, and in particular, in California.
12 The Commission announced that it would move to expedite the
13 certification process for additional natural gas pipeline
14 capacity into the west. The Commission has also requested

15 comment on additional action it might take to increase gas
16 supplies in California.

17 This past Wednesday, on May 16th, the Commission
18 acted to removed obstacles to increase energy supply by
19 temporarily waiving its regulations, and to increase pipeline
20 construction, and to permit certain rate treatments of
21 construction costs that will expedite pipeline construction of
22 facilities serving California.

23 On May 24th, the Commission staff will convene a
24 technical conference to address current and projected natural
25 gas pipeline capacity into California, as well as the adequacy
26 of the natural gas infrastructure into California.

27 With respect to the infrastructure, improvements
28 are greatly needed throughout the west, especially in

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1 California. We need to create appropriate financial incentives
2 to ensure that new generation is built, that the transmission
3 system is upgraded, and that new gas pipelines are built.

4 The Commission has taken action to try to ease
5 any interstate pipeline capacity constraints. In only 21 days,
6 a major pipeline system was approved. We recently, May 7th,
7 also approved the expansion of the El Paso system to provide an
8 increase in incremental capacity to California.

9 The intrastate pipeline system must also be
10 expanded so that California pipeline infrastructure can handle
11 the capacity from the interstate markets.

12 As you can see, the Commission has taken many
13 actions recently to try and help the California energy markets.
14 In addition to these efforts, the Commission has increased its
15 Market Oversight and Enforcement staff by 25 percent since the
16 first of the year. The Commission has created a new section
17 entitled, Energy Markets, and devoted significant resources to

18 this group to help it monitor and investigate gas and
19 electricity markets, with particular emphasis on California.

20 Commission staff is investigating all outages in
21 California, both planned and forced, to determine if the outages
22 are an attempt to influence market prices through the
23 withholding of power. Staff has conducted on-site inspections
24 to determine if the outages were legitimate. And if so, whether
25 repairs were made in a timely manner.

26 Staff is examining bid data submitted by
27 generators operating in California to see if generators are
28 exercising market power by economic withholding of power, or to
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1 determine if patterns suggestive of manipulation or collusion
2 exist.

3 In addition, the Commission is reviewing the data
4 submitted in response to the Commission's March orders
5 establishing a break point for bids.

6 The Commission is also actively investigating
7 transactions involving natural gas. The Commission is examining
8 all transportation capacity releases on interstate pipelines
9 that are made above the FERC-approved maximum transportation
10 rate.

11 Staff is conducting audits of certain generators
12 that operate in California, with particular emphasis on the gas
13 purchasing practices of the generators, especially with their
14 affiliates.

15 Staff is monitoring transactions between shippers
16 and generators to determine if price manipulation is occurring.

17 Staff is analyzing the prices, commodity and
18 transportation, that shippers and marketers pay into
19 California.

20 Staff is examining the amount of capacity of

21 interstate pipelines coming into the California, the capacity on
22 intrastate pipelines inside of California, and the types of
23 transactions that the customers are entering into.

24 The Commission remains willing to work in a
25 cooperative and constructive manner with California to help
26 resolve the problems in the energy crisis.

27 Thank you for the opportunity to present these
28 views, and I'll be happy to answer any questions that you may
10

1 have.

2 CHAIRMAN DUNN: As you can imagine, we probably
3 have a couple. I know Senator Bowen has number of questions.

4 I want to ask you a few questions, then go to
5 Senator Bowen and the other Senators that may have questions.

6 You mentioned the word that we have discussed,
7 debated, analyzed, dissected, over the course of our hearings,
8 including this morning, and that is the phrase "market power."

9 How does FERC define that phrase, market power?

10 MR. PEASE: I'm not sure if the Commission has
11 expressly defined market power. But staff operates under the
12 same definition that you read earlier this morning from the
13 Department of Justice.

14 CHAIRMAN DUNN: Okay. I'm trying to figure out
15 its application here.

16 So, you would agree, at least from your
17 perspective as staff, that the definition that I read from the
18 Department of Justice before is a fair definition of market
19 power.

20 MR. PEASE: Yes, sir.

21 CHAIRMAN DUNN: And the critical aspect of market
22 power, as it relates to FERC, is that proof of not having market
23 power was necessary for any market participant to move from

24 cost-based rates to market-based rates; is that correct?

25 MR. PEASE: That's fair.

26 CHAIRMAN DUNN: In other words, restating it
27 differently, if I was a market participant and operating in a
28 given wholesale market, I'm under cost-based rates that were
10

1 described earlier. I would like access to market-based rate
2 authority. I have to demonstrate to FERC that I do not have
3 market power in that given area.

4 MR. PEASE: That is correct.

5 CHAIRMAN DUNN: Do you know what happens within
6 the FERC process if, in fact, it can be demonstrated
7 retroactively that a market participant had market power, even
8 though at the time they made their application, they claimed not
9 to have market power?

10 MR. PEASE: There are a number of complaints
11 before the Commission on that very issue. So, that matter is
12 directly before the Commission.

13 Certainly one of the options to the Commission
14 is, if it finds that a particular entity has market power, to
15 either put restrictions on their market-based rates, or -- and
16 going as far as revoking those market-based rates.

17 There have certainly been calls, and particularly
18 with Commissioner Massey, for the Commission to review its
19 hub-and-spoke analysis, which I am not expert on, but to review
20 the method by which the Commission has determined whether a
21 company has market power or not. Those issues are directly
22 before the Commission now.

23 CHAIRMAN DUNN: If in fact, hypothetically, such
24 a finding was made that we can establish that a given
25 participant had market power from a date, say, a year ago, does
26 FERC have the authority to retroactively go back to that period

27 of time and make redress?

28 MR. PEASE: The Commission's authority is

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1 essentially two-fold.

2 Under the Federal Power Act, the Commission has
3 to set what we call a refund date, and the Federal Power Act
4 provides that it has to be 60 days from the date that the
5 Commission initiates an action or a date a complaint is filed.
6 That date is October 2nd of 2000, based on the complaint that
7 was the filed by San Diego Gas and Electric.

8 From that point, October 2nd on, the Commission
9 certainly has the ability to issue refunds for any transaction
10 that occurred during that period of time where it found
11 market -- it was abusing market-based rates.

12 Prior to that date, or at any date, if the
13 Commission makes a specific finding, for example, approving the
14 AES settlement, there the Commission did make a finding. But in
15 that case, the Commission -- in situations like that, where the
16 Commission either is alleging or finds violations of any
17 Commission rule, regulation, order, or the statutes under our
18 jurisdiction, in this case the Federal Power Act, the Commission
19 could order specific refunds of the transactions in question.
20 But in that instance, as opposed to the October date, you would
21 have to have a specific finding of violation.

22 CHAIRMAN DUNN: And if there's no such finding,
23 then it would be outside of the FERC ability to act?

24 MR. PEASE: Prior to October 2nd.

25 CHAIRMAN DUNN: All right, Senator Bowen.

26 SENATOR BOWEN: Thank you.

27 I'd like to start with just exploring the
28 market-based rate issue, just so that we can have a sort of

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1 common understanding of what we're talking about.

2 What is the statutory basis under which FERC
3 grants market-based rates?

4 MR. PEASE: The Commission has the authority to
5 set just and reasonable rates under the Federal Power Act. The
6 Commission over time has interpreted that to meaning cost-based
7 rates, which meant that in this instance, a generator or a
8 natural gas supplier would get the costs of their -- what it
9 cost to produce the power plus a certain profit. That was our
10 traditional cost-based rates that we did over the years.

11 In the late '80s and '90s, the Commission started
12 to move towards market-based rates, first in the gas area. And
13 it determined that market-based rates were just and reasonable
14 under the Federal Power Act.

15 And later, as part of the deregulation efforts on
16 the electricity side, it found that market-based rates fell
17 under the just and reasonable standard of the Federal Power Act
18 for the various markets across the country.

19 SENATOR BOWEN: So, there's no specific
20 authorization. The Federal Power Act, obviously, was created
21 at a time when nobody had ever heard of market-based rates.

22 MR. PEASE: That's correct.

23 SENATOR BOWEN: So, the grant of market-based
24 rate authority is then an extension, under some extension of the
25 Federal Power Act provisions that simply require just and
26 reasonable wholesale rates, but there's no specific provision?

27 MR. PEASE: That's correct. There's no specific
28 provision for any type of rates, other than just and reasonable

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1 in the Federal Power Act. Cost-based rates are not specified in
2 the statute, nor any particular method.

3 So, I wouldn't call it an extension, but in

4 layman terms, that's just fine.

5 Legally, I would describe it as, that's the
6 Commission's interpretation of what the just and reasonable
7 standard requires.

8 SENATOR BOWEN: Has the FERC established any kind
9 of regulations or standards for the grant of market-based rate
10 authority?

11 MR. PEASE: The Commission has issued a number of
12 orders over the years as to its standard that it has used, which
13 is the hub-and-spoke, to simplify, and as I said before, I am
14 not an expert on that. I'd rather let the Commission orders
15 speak for themselves on that particular topic.

16 SENATOR BOWEN: Can you explain, and I think it's
17 going to be difficult for the committee to understand these
18 issues without knowing at least generally how the hub-and-spoke
19 works.

20 MR. PEASE: The analysis goes to the amount of
21 penetration, percentage, that is dominated in the market by a
22 particular generator. It's part of that analysis.

23 And where the Commission finds it doesn't exceed
24 a certain threshold, then the Commission has -- I'm greatly
25 simplifying here -- granted market-based rates.

26 SENATOR BOWEN: Is there any provision in the
27 Commission's orders under which revocation would occur? Is there
28 any standard for when revocation of market-based rate authority

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1 would occur?

2 MR. PEASE: No. The Commission has articulated
3 that it has found that the rates were not just and reasonable in
4 the December 15th order, but the Commission has not articulated
5 across the board what standards it would use to revoke market
6 power.

7 And as I said earlier, on individual cases the
8 Commission can review it, and has before it complaints, where
9 the complainants have asked the Commission to review whether
10 market-based rates were appropriate for particular entities.

11 CHAIRMAN DUNN: Senator Bowen, if I may interrupt
12 for just one quick question.

13 Clarification, again, for our sake, and I think
14 for the attendees today.

15 We've talking about market power, proof of
16 nonmarket power, your ticket into market-based rates.

17 Correct me if this is not a fair description.
18 Market-based rates, versus what you describe as cost-based
19 rates, is basically whatever a free and competitive market
20 dictates, that's the price.

21 I know I'm stating it pretty broadly, but do you
22 disagree with that?

23 MR. PEASE: In layman terms, that's not an
24 inaccurate statement.

25 But sometimes, if the market must pay prices that
26 are -- even though it's under market-based rates, the Commission
27 can find and has found that those costs may be unjust and
28 unreasonable, and therefore, would violate the market-based

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1 rates.

2 CHAIRMAN DUNN: I just wanted to clarify that for
3 everybody. Excuse me, Senator Bowen.

4 SENATOR BOWEN: Has the Commission ever revoked
5 market-based rate authority?

6 MR. PEASE: Not to date, no.

7 SENATOR BOWEN: For what time period does a grant
8 of market-based rate authority extend? It's not permanent;
9 right?

10 MR. PEASE: No. I believe they were initially
11 conditioned on three-year periods, and to make filings after
12 three years to demonstrate that they were not exercising market
13 power.

14 SENATOR BOWEN: Let's talk about that for a
15 minute.

16 The renewal, then, of that first grant of
17 market-based authority requires filings by the traders or
18 generators?

19 MR. PEASE: Yes.

20 SENATOR BOWEN: What standard will the Commission
21 use in ascertaining whether or not -- I mean, we're in a very
22 different position now than we were when the initial rate
23 authority was granted, because it was all theoretical at that
24 point. There had never been a market, so there were certainly
25 lots of projections. In fact, I think FERC itself projected
26 that wholesale costs would be three to six cents a kilowatt
27 hour.

28 Now we have a track record. What evidence will
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1 the Commission require, and what standards will the Commission
2 use to make the determinations that will be forthcoming in the
3 next few months?

4 CHAIRMAN DUNN: Mr. Pease, before you answer,
5 I've already introduced Senator Escutia, but now joining us on
6 the dais is Senator Sheila Kuehl from the Los Angeles area.

7 Welcome, Senator.

8 Excuse me, Mr. Pease.

9 MR. PEASE: I can't speculate as to what the
10 Commission would do in the future on those orders.

11 The Commission has not stated that it is going to
12 take any particular action, and those issues are directly before

13 the Commission on a number of cases.

14 SENATOR BOWEN: How would a consumer, or a
15 utility, or a state regulator, know what the standards were in
16 trying to present a case?

17 MR. PEASE: Until the Commission acts otherwise,
18 the standards are what's in place today.

19 SENATOR BOWEN: But there is no order that I'm
20 aware of that deals with the renewal of market-based rate
21 authority. Am I missing it?

22 MR. PEASE: No, there have been none yet to date.

23 SENATOR BOWEN: So, we don't know, then, how the
24 Commission will make a decision?

25 MR. PEASE: That's correct.

26 CHAIRMAN DUNN: Is this a bit like the Supreme
27 Court decision that said, "I can't define obscenity, but I know
28 it when it see it?"

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1 SENATOR BOWEN: We were actually talking about
2 that, but that was far more out in the open, I think.

3 I'm just focusing on how someone would go about
4 ascertaining even what kind of information to present as
5 evidence, or if evidence is even required.

6 Do you know if evidence will be required?

7 MR. PEASE: I would expect that if one wanted to
8 challenge a particular market-based rate that was given to a
9 company, that you would want to present evidence showing that
10 that entity did indeed have market power.

11 SENATOR BOWEN: But in a renewal, isn't the
12 burden on the Federal Energy Regulatory Commission rather than
13 on an opponent?

14 MR. PEASE: The burden is always on the
15 Commission to issue the orders, and the Commission has to

16 justify its orders, or they're subject to challenge by the
17 court, and subject to reversal by the court.

18 SENATOR BOWEN: So procedurally, how will the
19 Commission go about undertaking the review to look at the
20 renewal of market-based rate authority? Will it open a
21 proceeding and ask for public comments?

22 MR. PEASE: Well, the Commission doesn't ask for
23 public comments.

24 SENATOR BOWEN: Or allow public comments.

25 MR. PEASE: Anyone can intervene in the
26 proceedings. If a marketer or generator submits a request to
27 renew the market-based rate authority, and makes the filings
28 after that three-year period, then certainly, anyone can enter

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1 -- any party can intervene into those proceedings and present
2 whatever information it thinks is relevant for the Commission's
3 consideration.

4 That doesn't mean the burden has shifted to those
5 parties, but it gives them an opportunity to be heard before the
6 Commission, and to present points of view that the Commission
7 may not be aware of.

8 But the Commission has the responsibility, should
9 no one file any comments, to justify an extension or
10 continuation of a generator's or marketer's market-based rate
11 authority. That burden always remains with the agency.

12 SENATOR BOWEN: It's my understanding that in the
13 last session of Congress, there was legislation that FERC
14 supported, or proposed legislation, that would have changed the
15 Federal Power Act's scheme for market-based rate authority.

16 Are you familiar with that?

17 MR. PEASE: No.

18 SENATOR BOWEN: Let's shift briefly to the

19 mitigation proposal. I know you said that the theory behind the
20 last mitigation proposal was that the unjust and unreasonable
21 rates are a function of lack of supply.

22 How are we to take the situation in which prices
23 went to \$1900 a megawatt hour at a time when reserves were above
24 seven-and-a-half percent and there was no supply shortage?

25 MR. PEASE: One of the other provisions of the
26 April 26th order is to force a selling obligation on the
27 generators, so that during all hours, not just during the Stage
28 One situation, the generators must offer all of their power,

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1 available power, to the ISO. This exempts hydro.

2 That's one of the means, in addition to the Stage
3 One, that the Commission is trying to implement, so that there
4 won't be withholding of power and driving up the prices to un
5 reasonable levels.

6 SENATOR BOWEN: The order applies just to
7 generators; right?

8 MR. PEASE: It applies to everyone selling power
9 into California, marketers as well.

10 SENATOR BOWEN: But you said before we broke for
11 lunch that it applied to California generators.

12 MR. PEASE: It applies to those -- I'll tell you
13 the exact language that the Commission has used for the price
14 mitigation.

15 First, on the selling obligation, it requires --
16 the Commission says it requires sellers with PGAs, which are
17 purchase gas agreements, as well as nonpublic utility generators
18 located in California that make sales through the ISO markets,
19 or that use the ISO's interstate transmission grid, with the
20 exception hydro-electric power, to offer all their available
21 power in real time during all hours.

22 So, what the Commission did here, and some have
23 criticized us for allegedly extending our jurisdiction to
24 include entities that were not traditionally under Commission
25 jurisdiction, but are using the grid.

26 Essentially what this order says is, if you're
27 using the grid, you have to make your power available.

28 SENATOR BOWEN: What's the enforcement mechanism?
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1 MR. PEASE: The traditional enforcement
2 mechanisms available to the Commission.

3 If the Commission finds that someone is not doing
4 that, the Commission can order refunds. The Commission could
5 order --

6 SENATOR BOWEN: Does the Commission have a staff
7 who is now evaluating that, or are you relying on someone filing
8 a complaint, which is the more traditional course?

9 MR. PEASE: We are not simply waiting for people
10 to file complaints, no. We have staff that are monitoring the
11 markets, looking at the data now, to try to examine it and see
12 if there were problems there.

13 SENATOR BOWEN: One other question about the
14 order.

15 On what basis can the FERC, what statutory basis
16 can the FERC order the state to make a voluntary regional
17 transmission organization filing as a condition of enforcement
18 of the Federal Power Act?

19 MR. PEASE: The Commission did not articulate a
20 great deal on that issue in the order.

21 I can tell you what my sense is of that, since I
22 don't have a tremendous amount of guidance from the Commission.

23 The Commission has said in other orders that it
24 views the problems in -- it views California not to be an

25 island, and that the problems that are existing in California
26 are also having a ripple effect throughout the west, and
27 problems in other parts of the west are having problems in
28 California, such as the lack of hydro power that traditionally
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1 has been sold into California in the summer.

2 So, the Commission is viewing this as a regional
3 problem, and is trying to find a regional solution to the
4 problem. The grid operates on regional basis, and I think
5 that's the direction that the Commission is trying to go into.

6 SENATOR BOWEN: I understand that, but that's
7 really not the question.

8 The FERC does not have the authority to order a
9 state to file an RT0 proposal; isn't that correct? I mean, they
10 some years ago started down that road and backed off when they
11 were challenged.

12 MR. PEASE: In Order 888, the Commission's big
13 order on -- I'm sorry, in Order 2000, excuse me, which was the
14 Commission's order on RT0s, the Commission made it voluntary,
15 RT0s on a voluntary basis.

16 When the Court of Appeals in the District of
17 Columbia reviewed Order 888, which was the order setting forth
18 the deregulation conditions, the Court seemed to go even beyond
19 what the Commission did in terms of making specific orders, and
20 implied in there the Commission may have the authority to order
21 such things as mandatory RT0s.

22 That, however, is not a clear judicial statement
23 on the matter. And the matter has not been brought directly
24 before the courts.

25 Personally, I certainly expect someone to
26 challenge that, challenge the Commission on its jurisdiction
27 there.

28 SENATOR BOWEN: Doesn't requiring a voluntary 11

1 filing as a condition of mitigation basically amount to a
2 mandatory filing requirement as a practical matter?

3 You basically have said, we're not going to
4 enforce the Federal Power Act unless you make a voluntary
5 filing.

6 MR. PEASE: I can see how you can reach that
7 conclusion.

8 SENATOR BOWEN: Do you disagree?

9 MR. PEASE: I'd rather not comment further on it.

10 SENATOR BOWEN: What fun is that.

11 CHAIRMAN DUNN: Senator Escutia.

12 SENATOR ESCUTIA: Well, to follow up on the issue
13 of this FERC order, self-destructing by June 1st, if this RT0 is
14 not filed, then my question to you is, what regulations to
15 control prices will be in place, since this earlier price
16 mitigation order will be superseded?

17 MR. PEASE: As I answered before, it's -- I would
18 not like to predict where the Commission is going. I don't
19 think as a staff member that's exactly my place.

20 There are a number of these issues before the
21 Commission. Certainly parties will be asking that question on
22 rehearing of this particular order.

23 SENATOR ESCUTIA: When is that rehearing taking
24 place?

25 MR. PEASE: Parties have 30 days from the date
26 that the Commission issues an order to file for rehearing. And
27 rehearing here is asking the Commission essentially to
28 reconsider any order the Commission issued, or for

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1 clarification, or whatnot.

2 SENATOR ESCUTIA: When is that 30 days?

3 MR. PEASE: The Commission issued its order on
4 April 26th, so it'll be 30 days after April 26th, any person
5 would have an opportunity to file and request rehearing of the
6 Commission's order.

7 SENATOR ESCUTIA: So, by May 26th, this request
8 for rehearing has got to be filed.

9 MR. PEASE: That's correct.

10 SENATOR ESCUTIA: And by June 1st of this year,
11 that order from FERC will basically self-destruct if this RT0 is
12 not filed?

13 MR. PEASE: That's what the Commission said in
14 the order.

15 SENATOR ESCUTIA: Thank you.

16 CHAIRMAN DUNN: Senator Morrow has some
17 questions.

18 SENATOR MORROW: Thank you, Mr. Chairman.

19 Mr. Pease, if the FERC had made a finding that
20 certain prices at a certain time were unfair and unjust, would
21 that in and of itself equate with the violation of the Federal
22 Power Act?

23 MR. PEASE: Not necessarily, no. The Commission
24 could make findings that what it thought were appropriate
25 charges no longer were appropriate, and therefore, should be
26 changed. It can do it across-the-board; it did it in Order
27 888. It did it in a previous order dealing with natural gas
28 prices, where it shifted its regulation from cost-based to

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1 market-based.

2 But a finding does not automatically lead to
3 that.

4 SENATOR MORROW: The rate-based authority, that's

5 found within the Federal Power Act?

6 MR. PEASE: Yes, sir.

7 SENATOR MORROW: A finding that there's been a
8 violation of the rate-based authority, would that be the same
9 answer necessarily? It wouldn't necessarily amount to a
10 violation of the Federal Power Act?

11 MR. PEASE: Well, if I understood the way you
12 just worded the question, I think you said if there was a
13 violation found, certainly then the Commission would look at
14 whatever remedies were appropriate.

15 SENATOR MORROW: If they found that certain rates
16 exceeded or were not within the rate-based authority, would that
17 be a violation of the Federal Power Act?

18 MR. PEASE: If the Commission found that someone
19 violated the terms of their market-based rates, the Commission
20 could order refunds.

21 SENATOR MORROW: At least it's now your view that
22 at least prior to October, that the FERC would not order refunds
23 unless they found a specific violation of the Federal Power Act;
24 is that correct?

25 MR. PEASE: That's correct. They couldn't order
26 across-the-board refunds until the Commission has made a finding
27 that they were unjust and unreasonable.

28 SENATOR MORROW: Thus far, they've made no such
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1 finding; correct.

2 MR. PEASE: That's right.

3 SENATOR BOWEN: I don't understand. The Federal
4 Power Act requires that any rate design result in just and
5 reasonable wholesale prices.

6 I read the FERC's order in the San Diego case
7 last year. It specifically makes a finding that rates were not

8 just and reasonable.

9 How is that anything other than a violation of
10 the Federal Power Act under any possible reading of the law?

11 How can you have a finding that rates aren't just
12 and reasonable, but say, oh, it doesn't violate the Federal
13 Power Act?

14 SENATOR MORROW: That was my next question.

15 MR. PEASE: It's a difficult question to answer
16 in layman's terms.

17 What the Commission found there was that the
18 market-based rates, as the market was construed at that point,
19 were unjust and unreasonable.

20 But it didn't make a finding as to any specific
21 generator. It didn't make any finding with respect to any
22 specific marketer.

23 It made an across-the-board finding that the
24 rates in place then were unjust and unreasonable. And at that
25 point, it can then order refunds for any specific transaction
26 that it found was not just and reasonable.

27 SENATOR BOWEN: What I'm hearing you say is lot
28 like what we tried with our parents when we were about nine,
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1 which is: Mom, everybody else is doing it, so it must be okay.

2 Basically what you're saying is, if the
3 violations are widespread and across-the-board, and everybody's
4 doing it, even if the result is unjust and unreasonable prices,
5 it's not a violation of the Federal Power Act.

6 MR. PEASE: No, what the Commission did then,
7 after it made that finding of unjust and unreasonable -- maybe
8 I'm not being clear. I'm probably not being clear, so let me
9 try again.

10 When the Commission made the finding that it was
Page 110

11 unjust and unreasonable, what it did then was, it then
12 reviewed -- so far it has not reviewed the prices in any orders
13 before January and February. And it looked at January and
14 February, and it found \$124 million worth of charges that it
15 believed were not just and reasonable, and it ordered the
16 generators to make refunds of that amount, unless they could
17 provide other information that the Commission was unaware of.

18 The Commission has yet to issue any orders for
19 the period of October, November, and December. And there, the
20 Commission certainly can order additional refunds. And from that
21 point on, the Commission can order refunds because it made the
22 finding that they were unjust and unreasonable.

23 In addition, the Commission could make specific
24 findings, and it has with respect to January and February, that
25 certain generators charged rates that were excessive, and it
26 said: Refund them. Those can be termed as violations; those
27 can be termed as unjust and unreasonable. That's why the
28 Commission ordered those refunds.

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1 SENATOR BOWEN: Is there a difference between an
2 unjust and unreasonable wholesale rates and a violation of the
3 Federal Power Act?

4 MR. PEASE: Yes. An unjust and unreasonable
5 would be, across-the-board, we find that these rates are no
6 longer supported.

7 When the Commission makes that type of a finding,
8 it's not saying that Generator X is manipulating the market by
9 themselves; it's finding across-the-board these rates -- the
10 Commission was wrong, essentially, and these rates now are not
11 just and reasonable, and so we're going to order refunds across
12 the board.

13 CHAIRMAN DUNN: If I can interrupt, Senator

14 Bowen, I want to ask one question, then we'll go back, since we
15 interrupted Senator Morrow.

16 My one question, Mr. Pease, is, so to what end do
17 we conclude that generically prices were unjust and
18 unreasonable?

19 You don't get to unjust and unreasonable unless
20 the market participants are charging unjust and unreasonable
21 prices individually. I don't know how every one of them can be
22 charging just and reasonable, but generically, the market is
23 unjust and unreasonable.

24 So, what's the purpose?

25 MR. PEASE: What the Commission then did was look
26 at the specific prices after that with the specific generators,
27 and as I said, it reviewed January and February, and then
28 ordered refunds for those months.

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1 CHAIRMAN DUNN: My question to you, Mr. Pease,
2 is: What's the purpose of doing a generic conclusion of unjust
3 and unreasonable?

4 MR. PEASE: It provides the Commission with the
5 basis to order refunds for all transactions, or whatever
6 transactions it finds are not just and reasonable during that
7 entire period of time.

8 CHAIRMAN DUNN: Wouldn't you have that if you
9 just look at the individual market participants?

10 MR. PEASE: Yes, we would.

11 CHAIRMAN DUNN: So, why do you do a generic
12 conclusion?

13 MR. PEASE: If you went by a case-by-case basis,
14 it's a significantly slower process, and you have not
15 articulated -- in this instance, the Commission will not have
16 articulated what the standards would have would apply

17 across-the-board. It would only be articulating them as they
18 apply to an individual generator or to an individual -- to an
19 individual transaction engaged in by an individual generator.

20 Instead, by going across-the-board, it provides
21 the Commission with -- the Commission now articulates a basis by
22 which it's going to order refunds across-the-board, and not just
23 on a case-by-case basis.

24 CHAIRMAN DUNN: Mr. Pease, maybe I'm just not
25 following this.

26 I don't know how you get to a generic conclusion
27 that the market has unjust and unreasonable prices without
28 looking at the market participants and potentially their unjust
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1 and unreasonable prices. You've got to conclude that
2 foundationally before you reach a generic conclusion. So, how
3 could it be a slower process?

4 MR. PEASE: I think what the Commission did was
5 both. The Commission looked at the market as a whole. It
6 looked at, for example, the instances in the past that Senator
7 Bowen referred to, \$1900 during a particular period of time, and
8 it looked at the market as a whole, as well as individual
9 generators, but looked at the market as whole and found, and
10 specifically stated in that December order that the market was
11 dysfunctional. It was not working as intended, and it was not
12 working as a competitive market.

13 And because it was not working as a competitive
14 market, the Commission made an across-the-board finding that the
15 rates were unjust and unreasonable.

16 CHAIRMAN DUNN: I'll try one more time.

17 That is, you said they did both. So, what's the
18 delay in zeroing in on the individual market participants who
19 are charging unjust and unreasonable prices, according to FERC?

20 MR. PEASE: The Commission is looking at those.

21 CHAIRMAN DUNN: No, my question is, that order
22 came down sometime ago generically, and to get to the generic
23 conclusion, you already indicated that you need to look at the
24 individual participants. So, why don't we just say what the
25 individual participants did?

26 MR. PEASE: The Commission did that for January
27 and February, but it has not done it for the other months.

28 CHAIRMAN DUNN: Senator Morrow.

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1 SENATOR MORROW: That leads in to my first
2 question.

3 What efforts, or am I hearing that the FERC
4 hasn't made any investigation at all with respect individual
5 market participants or individual transactions prior to January
6 of this year?

7 MR. PEASE: No, that would not be accurate.

8 The Commission is looking at the prices during
9 the previous period, the period before January. The Commission
10 has not issued any orders yet on that.

11 SENATOR MORROW: Let me ask the question another
12 way, an open-ended question.

13 What efforts or what has the FERC been doing with
14 respect to investigation of individual market participants and
15 transactions prior to January?

16 MR. PEASE: I cannot discuss any specific cases
17 that the Commission may have. I'm restricted by the
18 confidentiality provisions.

19 SENATOR MORROW: Does that investigation go back
20 to June of 2000?

21 MR. PEASE: I cannot discuss that.

22 The Commission is looking at all information it

23 has before it.

24 SENATOR MORROW: I guess what we're trying to get
25 at is, how well they're looking?

26 MR. PEASE: I understand that.

27 SENATOR MORROW: Let me ask you this, Mr. Pease.
28 I believe you were here this morning. Did you hear the

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1 testimony of our State Auditor, Elaine Howle?

2 MR. PEASE: Yes, I did.

3 SENATOR MORROW: Are you familiar with the State
4 Audit Report?

5 MR. PEASE: Somewhat.

6 SENATOR MORROW: In it, and consistent with her
7 testimony, she indicated that a finding, or at least that there
8 were indicators there on the part of suppliers of withholding
9 supply or withholding capacity.

10 Assuming for a moment, I mean, if that were true,
11 and there were underscheduling of supply or capacity, could that
12 amount to a violation of any administrative, or regulatory, or
13 statutory rule, federal or state?

14 MR. PEASE: Yes.

15 SENATOR MORROW: Going on to the next one, I want
16 to clarify this.

17 I think you also indicated, and I'm unclear on
18 this, I think that you said, as confidential items that were
19 provided to the FERC, it was in your view that almost all, or
20 99.8 percent, or whatever, of those items had already been
21 provided to the ISO. Did I understand that right?

22 MR. PEASE: I think reverse that. Almost all of
23 the information is provided directly to the ISO, not directly to
24 FERC.

25 SENATOR MORROW: I'm sorry. So, the FERC has

26 never received that information?

27 MR. PEASE: No, we've gotten a lot of the
28 information since that point, but the initial disclosing of the
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1 bid data was made directly to the ISOs.

2 SENATOR MORROW: Here's where --

3 MR. PEASE: We have the information now, yes.

4 SENATOR MORROW: Are you familiar with the
5 Joskow-Kahn Report?

6 MR. PEASE: I've read it.

7 SENATOR MORROW: Both contained in that report,
8 and I don't think I'm venturing too far to say that our State
9 Auditor, in response to one of my questions, felt or said that
10 there was information that FERC had, was in possession and only
11 FERC had, that they didn't have privy to, that they felt should
12 be examined.

13 Do you agree with that?

14 MR. PEASE: I'm not sure I understand your
15 question?

16 SENATOR MORROW: I'm trying to find out,
17 according to the reports that I've read, and let me go to one.
18 This is the Joskow-Kahn Report, dated last November, "Analysis
19 of Price and Behavior in California's Wholesale Electricity
20 Market During the Summer of 2000."

21 It was their conclusion that the analysis, their
22 analysis, suggests that:

23 "A more detailed examination
24 of supplier withholding behavior
25 for generators inside and outside
26 of California and for wholesale
27 aggregators is warranted. This is
28 the kind of analysis that the FERC

1 staff can pursue in the future
2 after gaining access to all of the
3 relevant confidential data for
4 generators and marketers inside
5 and outside of California that
6 are buying and selling in the
7 California market."

8 Given that, I guess my question is: Does FERC
9 have all relevant, confidential data for generators and
10 marketers inside and outside of California to make that
11 determination?

12 MR. PEASE: I believe that information is at
13 FERC, yes.

14 SENATOR MORROW: If that information is at FERC,
15 how much of that information has been provided, if you can
16 comment, to the California ISO?

17 MR. PEASE: I can't comment on that. I cannot
18 comment on that.

19 SENATOR MORROW: You cannot comment because of
20 confidentiality, or simply no knowledge?

21 MR. PEASE: Because of the confidentiality
22 provisions.

23 SENATOR MORROW: You can't even give me a
24 percentage, 50 percent ballpark figure?

25 MR. PEASE: No, I cannot discuss that at all.

26 I can tell you that the ISO and FERC share
27 information constantly, and that the recent order, the April
28 26th order, provides even more mechanisms for the exchange of
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1 information between FERC and the California ISO, and
2 specifically requires the California ISO to share all outage

3 information, among other information, with FERC. It requires
4 them to file weekly reports as well as a quarterly report on how
5 the markets are working.

6 So, yes, we do exchange information regularly.

7 I know it's frustrating, but I'm sorry, I cannot
8 comment on specific information that's exchanged.

9 SENATOR MORROW: But you do exchange confidential
10 information with the ISO, and I'm assume it's subject to
11 whatever confidentiality agreement you have with the market
12 participants; is that right?

13 MR. PEASE: It is subject to the requirements set
14 forth in the tariff and in our regulations that I discussed this
15 morning.

16 SENATOR MORROW: So, you're not precluded,
17 subject to those requirements, of sharing that information with
18 other agencies; correct?

19 MR. PEASE: Other than the restrictions that are
20 placed there, no.

21 SENATOR MORROW: And if a state agency agreed to
22 comply with all of those restrictions that you're referring to,
23 FERC could provide that information; could they not?

24 MR. PEASE: I'd rather let the Commission address
25 that on case-by-case basis.

26 SENATOR MORROW: I understand that, but I'm kind
27 of looking for a legal conclusion here, which I'm hoping will
28 fall in your bailiwick.

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1 MR. PEASE: There is no obvious prohibitions on
2 the Commission doing that.

3 CHAIRMAN DUNN: Senator Kuehl.

4 SENATOR KUEHL: Thank you, Mr. Chairman.

5 Mr. Pease, I want to return just a minute to the

6 issue of just and reasonable, or unjust and unreasonable.

7 I was a little confused by sort of the issue of
8 time and conclusion. The Commission made its finding that,
9 across-the-board, prices were not just and reasonable.

10 What was the earliest point in time to your
11 knowledge that they made that conclusion?

12 MR. PEASE: The Commission made that in a
13 December 15th, 2000 order, I believe.

14 SENATOR KUEHL: And what is the sort of evidence
15 taken into account that leads the Commission to conclude that
16 prices across-the-board are not or were not just and reasonable?

17 MR. PEASE: In that order, the Commission looked
18 at a number of factors, and in particular, it looked to how the
19 market was functioning, how the prices had soared, why, and the
20 Commission looked at some reasons and why this crisis had
21 soared, including the shortages and other issues.

22 It found, based on that record, that the rates
23 were unjust and unreasonable.

24 SENATOR KUEHL: Compared to something?

25 MR. PEASE: I'm not sure it made a specific
26 comparison to any other timeframes.

27 SENATOR KUEHL: You indicated a few minutes ago
28 that the Commission concluded that the market was not

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1 competitive.

2 So, I guess I'm trying to understand the elements
3 that would be taken into account by the Commission to bring them
4 to that conclusion? That is, if there were different prices
5 charged by different generators, no matter how high, the market
6 would be seen to be competitive? But if the prices were
7 amazingly similar, the market is noncompetitive?

8 MR. PEASE: I don't think that's exactly the way

9 the Commission looked at it.

10 What the Commission looked at was, that even in
11 emergency situations, or in other situations, it found that the
12 market was not functioning as the Commission expected a
13 competitive market to be functioning.

14 You saw some of the -- you weren't here this
15 morning, and some of the slides that the State Auditor put up,
16 and her bar essentially would show where the prices were not
17 fluctuating much in the past. And that's the way, I think, the
18 Commission expected a competitive market to function.

19 And it is exactly the way the market functioned
20 in the natural gas area for a number of years until this past
21 summer and fall, where prices were much more competitive. You
22 did not see unusual bidding behavior. You did not see unusual
23 and repetitive price spikes occurring. Those markets were
24 functioning competitively for a long time, and they seem to be
25 going back to functioning competitively as the gas prices now
26 are dropping considerably.

27 When the Commission looked at the electric
28 market, particularly in California, it did not see that type of
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1 a record. So much different than that.

2 SENATOR KUEHL: We're, of course, not seeing the
3 prices dropping in California.

4 MR. PEASE: Not yet.

5 SENATOR KUEHL: The issue of a decision about
6 anti-competitive or noncompetitive behavior in the market, you
7 indicated that one of the elements that the Commission looked at
8 had to do with shortages, or how much power was available, and
9 how much was, in essence, rendered unavailable.

10 There had been some claim recently that the
11 Commission was not looking at those issues during times when

12 California might have been in a Stage One or Stage Two alert,
13 but only sort of in extremis at Stage Three.

14 Is that the case?

15 MR. PEASE: Initially, when the Commission issued
16 its first orders that I referred to in January and February, and
17 ordered \$124 million in refunds, the Commission came up with a
18 proxy price, or a price that it thought reflected a competitive
19 market. And it ordered refunds of anything above that price.

20 The proxy period that the Commission used to
21 determine the refunds for January and February was a Stage Three
22 emergency situation.

23 The Commission -- both those orders are directly
24 before the Commission on rehearing, and there have been requests
25 that the Commission should instead look at all hours, or at the
26 minimum, look at Stage One.

27 In the most recent order, April 26th order, where
28 the Commission set forth the latest market mitigation plan, the
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1 Commission set the proxy price, which is really looking at
2 developing a marginal cost price at Stage One. So, the
3 Commission in that order is not restricting the proxy price to
4 Stage Three, as did in ordering the earlier refunds. But on
5 this one it went to Stage One.

6 Commissioner Massey's dissent to that order
7 challenged the Commission's rationale for restricting it to
8 Stage One. And instead, he believed that it should be at all
9 hours. The other two Commissioners currently on the staff -- at
10 the Commission voted differently and restricted it to Stage One.

11 I can't tell you what the Commission will do on
12 rehearing. I certainly expect those issues to be raised on the
13 April 26th order. Shocked if they were not. And they have been
14 directly raised on earlier orders of the \$124 million in

15 refunds.

16 If the Commission had looked at earlier stages,
17 Stage One, and developed the proxy price, the refunds certainly
18 would be of a higher magnitude than \$124 million. I do not know
19 what that figure would be, because the Commission has not
20 articulated, should it even change from the Stage Three for that
21 period, what that proxy price would be.

22 SENATOR KUEHL: Thank you, Mr. Pease, and thank
23 you, Mr. Chairman.

24 CHAIRMAN DUNN: Let me in order here. The next
25 one is Senator Escutia. But before we do that, I want to ask
26 your permission, Mr. Pease, about one thing.

27 You and I briefly discussed the schedule before.
28 You're not under a time commitment this afternoon? No plane to
13

1 reach later on?

2 MR. PEASE: No, Senator.

3 CHAIRMAN DUNN: The reason I say that, Mr. Pease,
4 is that we do have a time constraint problem with Loretta Lynch,
5 the head of the PUC. So, with your indulgence, and the
6 indulgence of the committee, it would be okay in about ten
7 minutes to interrupt your testimony and bring her on and allow
8 her to testify, and then we'll finish after.

9 Would you be okay with that.

10 MR. PEASE: That's fine, Senator.

11 CHAIRMAN DUNN: Any objections from the committee
12 members at all? We've still got some time, so we can go to
13 Senator Escutia, and then we'll get back to Senator Morrow.

14 SENATOR ESCUTIA: I guess I wanted to follow up
15 on the questioning along the lines that Senator Morrow had with
16 regard to trying to determine what information is available to
17 determine the market conduct of these participants. And since

18 you could not describe as to what percentage of that information
19 got to FERC from ISO, you could not comment, you said, then I
20 guess just to close the loop, I just want to make sure -- and
21 excuse me, because I'm also a lawyer by training. I always feel
22 that we have to ask all the questions and just close the loop.

23 If I were ask you if you can describe the
24 documents that prove or disprove market conduct, you're going to
25 tell me you cannot comment on that?

26 MR. PEASE: That's right, Senator.

27 I can comment on, you know, generic matters, and
28 the types of things, as I said in my prepared testimony, what we
13

1 look at in trying to determine whether violations are occurring.

2 My staff is looking at, for example, as I said
3 earlier, all outages that are going on in California, whether
4 they're planned or whether they're forced, to look and see with
5 those particular generators whether they're withholding power.
6 And by withholding power, driving up the prices and manipulating
7 the markets.

8 We've sent people out to audit the various
9 generators. We've looked at their purchasing practices. We've
10 looked whether they're trying to manipulate the prices by giving
11 higher contracts, for example, on the gas side with their
12 affiliates.

13 I mean, there's a number of different issues like
14 that that we look at and examine all the time, and are doing
15 that today with respect to the activity in the California energy
16 markets. So, I can comment to that extent, but I can't comment
17 on specific cases, specific investigations, or specific
18 documents.

19 SENATOR ESCUTIA: All right. Obviously, all
20 those documents that you have in your possession, whether they

21 were given to you by the participants or whether these were
22 documents that you unearth as a result of your investigations
23 into that kind of conduct, I'm assuming you, the agency, has
24 made all those documents confidential.

25 MR. PEASE: The Commission has not released any
26 of those documents to date.

27 SENATOR ESCUTIA: Mr. Chairman, I would just like
28 to find out if it is at all possible, because in the earlier
13

1 discussion we had with Mr. Pease before the lunch break, he
2 indicated that if a court order so allowed, you know, for these
3 documents to be made public, that a court order, that would be
4 the proper way to seek the disclosure of these documents; right?
5 That's what you said?

6 MR. PEASE: I'm not sure that's exactly what I
7 said in context.

8 What I was discussing there would have been the
9 process that would be going through for a FOIA request, a
10 Freedom of Information Act request.

11 The Commission can, by its own motion, or at a
12 request of another party or entity, make documents public.

13 What I was referring to in terms of the court
14 would have been a situation, a hypothetical situation, where
15 someone requested specific documents under FOIA from FERC, and
16 if FERC had declined to make those documents public, that party,
17 entity, could take the matter to court to seek disclosure of
18 those documents under FOIA. Then the Commission would have to
19 justify why it wanted to keep those documents confidential.

20 SENATOR ESCUTIA: Under FOIA, it very clearly
21 states that if the purpose of disclosure, you know, enables law
22 enforcement purposes, or the public interest, then the documents
23 should be released.

24 MR. PEASE: That's one of the provisions in FOIA.

25 SENATOR ESCUTIA: And those provisions are very
26 much parallel to the internal provisions of regulations of FERC;
27 is that correct?

28 MR. PEASE: That's correct.

13

1 SENATOR ESCUTIA: But you're saying that
2 obviously if a lawsuit were to be filed to ask for disclosure,
3 and if disclosure were to be denied, then at that point you
4 would have to go into court and fight it out in order for these
5 documents to be disclosed?

6 MR. PEASE: That would be correct.

7 SENATOR ESCUTIA: Well then, Mr. Chairman, I
8 don't know what is the status of this lawsuit that was filed by
9 our legislative leaders against FERC. I don't know if, in fact,
10 that lawsuit has been filed or not.

11 But I would be very interested in perhaps
12 exploring the possibility that that lawsuit, basically the State
13 of California against FERC, should include perhaps a cause of
14 action, or first the opening salvo at the State of California
15 receiving some of these documents that have been deemed
16 confidential, but that are very much relevant to establishing
17 what is market conduct, and whether it is good conduct or bad
18 conduct.

19 I think we should therefore basically start the
20 ball rolling with regard to trying to go into court, or make the
21 relevant FOIA request in order to set the proper remedies in
22 place. I would just like to eventually see if you, under your
23 Chairmanship, can approach the leadership about trying to see
24 whether we can somehow attach ourselves there, and making sure
25 that the documents, at least we should establish some kind of a
26 cause of action so the documents can be released.

27 CHAIRMAN DUNN: Senator Escutia, what we have
28 done is, unrelated to that potential lawsuit that you

13

1 referenced, we have -- and it should be available on Monday --
2 are drafting a formal request to FERC for the documents. So,
3 that process is actually under way.

4 The only add-on, then I'm going to go to Senator
5 Morrow here, is that from your perspective, Mr. Pease, what
6 you've described puts us in a very difficult bind. And that is,
7 if we ask for certain data, and you say we can't give you any of
8 that requested data, it's confidential, how do we test that?

9 I don't mean the forum, such as, do we test that
10 in front of FERC or in the court.

11 But rather, since you aren't obliged to give us a
12 list of the documents that you're claiming to fall within the
13 confidentiality provisions, we have absolutely no basis to start
14 that process, because you're not going to tell us what's in the
15 document. In fact, you're not even going to tell us what
16 documents they are.

17 Is that a fair description?

18 MR. PEASE: No, I don't think so.

19 At this point, there has been no request of the
20 Commission for the documents.

21 CHAIRMAN DUNN: Understood, from this committee,
22 that's correct.

23 MR. PEASE: So, to speculate as to what the
24 Commission would do in response to that, to any request that
25 would forthcoming, I would rather not speculate on what the
26 Commission would or would not do, since the Commission does not
27 have that issue before it today.

28 CHAIRMAN DUNN: Okay, but again, hypothetically,
14

1 and I'm not trying to put words in your mouth, Mr. Pease.

2 I believe you indicated in response to some of
3 the other questions that we wouldn't even do the confidentiality
4 provisions that apply to FERC. We won't even discuss the
5 categories of documents that are covered by our confidentiality
6 provisions.

7 And if I'm correct in that statement, you put
8 those of us on the outside world at a decided disadvantage for
9 purposes of challenging, if we so desire, the claim of
10 confidentiality via FERC.

11 MR. PEASE: I'm not sure that's entirely
12 accurate, Senator.

13 As I said before, I am not an expert on FOIA and
14 the various provisions. But it is my understanding that there
15 are provisions in FOIA where, if an agency is declining to turn
16 over information, it must list the categories of that
17 information.

18 CHAIRMAN DUNN: And last question, then, to
19 Senator Morrow, and then we'll interrupt you one more time,
20 Mr. Pease.

21 Is what you've just said, that the process by
22 which we ought to follow our request to FERC is technically an
23 FOIA request, and not something different than an FOIA request?

24 MR. PEASE: The Commission's standards,
25 specifically in 308812 that we talked about this morning,
26 specify the Commission will use the FOIA standards.

27 CHAIRMAN DUNN: Here's where I'm coming from. I
28 hear your answer, but here's where I'm coming from.

14

1 If we follow what I thought you said, and that's
2 just make a formal FOIA request, what I don't want to have
3 happen is that FERC responds to us by saying, "Everything that

4 you've requested is confidential. We're not required, we aren't
5 bound by FOIA requests to give you a list of the documents for
6 which we are claiming confidentiality." Then we're right back
7 to square one.

8 And I suspect if we made a formal FOIA request,
9 that's the response we would get.

10 Am I off base anywhere there?

11 MR. PEASE: I'd rather not say.

12 CHAIRMAN DUNN: Senator Morrow.

13 SENATOR MORROW: Real quick, trying another way.
14 I don't mean to put you on the spot. I might try a back way,
15 trying to get some information, but I can assure you, it's fair,
16 my way of trying to do it here.

17 Earlier, and I read from the Auditor's Report. I
18 wasn't there. Tell me if it's true.

19 The State Auditor in her report stated that FERC
20 informed the Western Governors Association in late December,
21 2000 that it would not pursue individual power generator
22 payments to those who purchased wholesale power because tracing
23 the transactions would be a time-consuming if not impossible
24 task.

25 First of all, to your knowledge was that a
26 correct statement? Is that what FERC told the Association?

27 MR. PEASE: I don't know that FERC made that
28 statement. I tried to check with my office during a break to
14

1 see if anyone who was there in Boise heard such a statement, and
2 no one there could verify that exactly those words were spoken.

3 I can say that it is more difficult, certainly,
4 to do it on a case-by-case basis, but I cannot say that it is
5 impossible to do that.

6 SENATOR MORROW: Well, that's a start.

7 I think I know the answer to the next question,
8 but I'm going to ask it anyway.

9 Is that what FERC is doing or not?

10 MR. PEASE: I can tell you that we are and have
11 ongoing investigations. And there I'm frustrating you again by
12 not telling you what the investigations are.

13 SENATOR MORROW: Okay, I'm used to it.

14 CHAIRMAN DUNN: Senator Bowen, and then we're
15 going to shift gears.

16 SENATOR BOWEN: So, let me just try to understand
17 something.

18 Earlier in the day, I had understood that
19 Independent System Operators and State Utility Commissions were
20 in a different position with regards to market monitoring,
21 market surveillance, and the information needed to adequately
22 conduct those functions with regard, in particular, to
23 information that was confidential under FERC tariffs, than my
24 dog, say.

25 Is there a difference between a Freedom of
26 Information Act request, which any citizen is entitled to file,
27 and the information that can be provided to the state and
28 regional authorities, and ISOs, and RTOs, whose primary job it
14

1 is to do market monitoring and surveillance?

2 MR. PEASE: There are provisions in the Federal
3 Power Act that deal with the disclosure of information submitted
4 during investigations. There are various rules that are set out
5 in the Federal Power Act of when the Commission can share
6 information with state and other federal regulators.

7 There's a number of provisions that were
8 submitted to me as background information. I can go over a few
9 of those, if you would like.

10 SENATOR BOWEN: So, the PUC and the ISO, then,
11 are not in same position as a rate paying business or citizen
12 who just wants information; is that correct or not?

13 MR. PEASE: It depends on the circumstance. For
14 example, there are a number of proceedings before the Commission
15 where the CPUC is a party before the Commission. And requests
16 for information there would be treated as any other party in the
17 proceeding.

18 With respect to matters where the CPUC is not a
19 party, or would not be a party to an actual Commission filing or
20 action, it may be treated differently.

21 SENATOR BOWEN: I gave you before lunch an
22 article from the New York Times. It raised several questions.
23 One of them, and you may or not may not know, and if you don't,
24 that's fine.

25 One of the comments that was made in the article,
26 one of the statements, is that the FERC staff did not enforce a
27 requirement that power companies file detailed quarterly reports
28 listing essentially every sale they made.

14

1 Do you know if that's accurate?

2 MR. PEASE: No, I do not.

3 I know that that information has been provided to
4 FERC and the ISO in a number of forums, but specifically that
5 form that is required to be filed quarterly, I don't know.

6 SENATOR BOWEN: I will wait on other questions.

7 CHAIRMAN DUNN: Mr. Pease, we're going to
8 interrupt you one more time. And I want to extend again our
9 gratitude for your patience in this regard. I know it's been a
10 long day, and unfortunately, it's going to be a bit longer.
11 Appreciate it very much, Mr. Pease. We'll get back to you as
12 quickly as possible.

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13 Evelyn, we're going to take five minutes for you
14 so you can rest now, then we'll get into Commissioner Lynch.

15 [Thereupon a brief recess
16 was taken.]

17 CHAIRMAN DUNN: Why don't we get underway, and
18 begin.

19 Erik, if you would please?

20 MR. LANGE: Please stand and raise your right
21 hand.

22 [Thereupon the witness,
23 LORETTA LYNCH, swore to
24 tell the truth, the whole
25 truth, and nothing but the
26 truth.]

27 MR. LANGE: Thank you. You may be seated.

28 CHAIRMAN DUNN: If you would, Commissioner Lynch,
14

1 give us just a brief background of your involvement with the
2 PUC, and include also a description of just generally the PUC
3 and its jurisdiction and so forth.

4 COMMISSIONER LYNCH: Certainly, thank you.

5 I was nominated to become a PUC Commissioner in
6 December of 1999, and became a PUC Commissioner in January of
7 2000. I then became the President of the Commission at the en
8 of March of 2000. So, I've been on the Public Utilities
9 Commission as a Commissioner since January of 2000,
10 approximately 16 or 17 months.

11 CHAIRMAN DUNN: And a description of the PUC just
12 generically?

13 COMMISSIONER LYNCH: Certainly.

14 The Public Utilities Commission regulates
15 investor-owned utilities, both natural gas and electricity

16 utilities, as well as commercial water companies, certain
17 transportation companies, and telecommunications companies.

18 CHAIRMAN DUNN: Your authority over market
19 participants in a wholesale market is what?

20 COMMISSIONER LYNCH: The Federal Power Act
21 contains a specific savings clause which saves to the states
22 regulation over generation facilities based in that state. And
23 pursuant to that savings clause of the federal statutes, the
24 Public Utilities Commission regulates for health and safety
25 purposes.

26 CHAIRMAN DUNN: So if I understand that
27 correctly, your authority over a local generation facility,
28 local being within California, is limited to health and safety
14

1 issues?

2 COMMISSIONER LYNCH: That's a question that is a
3 point of contention between the in-state generators and the
4 Public Utilities Commission.

5 CHAIRMAN DUNN: Senator Bowen.

6 SENATOR BOWEN: One follow-up on that point.

7 Next week, we'll hear a bill that Senator
8 Battin's presenting that deals with the health, in fact, life or
9 death impacts of generation outages in very hot areas of the
10 state where the increase in deaths, particularly among senior
11 citizens, goes up.

12 Is it a health and safety impact to have outages
13 and a lack of generation that result in blackouts in the state,
14 in your opinion?

15 COMMISSIONER LYNCH: Absolutely.

16 CHAIRMAN DUNN: We've talked about the infamous
17 issue of confidentiality in the past. And again, for purposes
18 of your later testimony here, I want to make sure we all

19 understand the parameters that you operate under as a
20 Commissioner with the PUC.

21 So, could you define for us the confidentiality
22 provisions that apply to you and your ability to provide
23 information.

24 COMMISSIONER LYNCH: Certainly.

25 The PUC certainly is covered by Government Code
26 Section 11183, which provides confidentiality for information
27 given to us by regulated companies.

28 As well, the PUC has its own confidentiality 14

1 provisions and can sign confidentiality agreements in order to
2 obtain business confidential information.

3 And finally, much of the information the PUC has
4 received with respect to investigations of generators and market
5 participants we have received from the Independent System
6 Operator, and that's covered by a protective order issued by the
7 Commission pursuant to negotiation with the Independent System
8 Operator. The Independent System Operator believed such a
9 protective order was necessary, because the information the ISO
10 receives from generators, they believe, is confidential under
11 the Federal Power Act.

12 So, some of the information we've received is
13 confidential pursuant to the ISO's rules and regulations,
14 which I understand to keep certain information confidential for
15 a period of six months from the transaction date.

16 CHAIRMAN DUNN: To put that in practical terms,
17 under normal day-to-day operations, the PUC would not be on the
18 receiving end of bidding data, for example, in the wholesale
19 electricity market?

20 COMMISSIONER LYNCH: That's correct.

21 CHAIRMAN DUNN: And to get that information, you

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22 need to request it from, for example, the ISO. And that's where
23 the ISO said, "We, the ISO, are covered by certain
24 confidentiality provisions as provided by the FERC tariffs?"

25 COMMISSIONER LYNCH: Yes, and in fact, the ISO
26 and the Power Exchange requested that we subpoena them. They
27 would not provide us data informally.

28 CHAIRMAN DUNN: Which leads to the question of,
14

1 since the bidding data, as one example, is not information that
2 would normally be submitted to the PUC, what initiated your
3 request and ultimately subpoena for that information from the
4 ISO?

5 COMMISSIONER LYNCH: Certainly.

6 On June 14th, the PG&E territory experienced the
7 first rolling blackout in my tenure on the Commission, a
8 blackout that was caused not by an equipment problem, which of
9 course occurs from time to time all over the state, but instead
10 was caused by a lack of supply availability.

11 On June 15th, or thereabouts, Governor Davis
12 requested Michael Kahn, who was then the Chairman of the
13 Electricity Oversight Board, and myself to investigate the
14 causes of the blackout, the June 14th San Francisco blackout,
15 and report back to him on those causes.

16 Pursuant to that request, Michael Kahn and I did
17 such an investigation, which resulted in our August 2nd report
18 to the Governor in which we laid out what we believed were the
19 causes of the blackout, and also went further to discuss the
20 dysfunctional wholesale electricity market that we believed
21 existed in California.

22 Right after that, on August 3rd, the Public
23 Utilities Commission approved an order instituting
24 investigation, which is our way of formally opening an

25 investigation into the functioning of the wholesale electric
26 market, and associated impact on retail rates.

27 So, pursuant to the Commission-ordered August 3rd
28 investigation, the Commission issued subpoenas to the ISO, to
14

1 generators, to market participants, to the Power Exchange,
2 requesting such information.

3 CHAIRMAN DUNN: If I can interrupt for one
4 second, Commissioner.

5 Prior to that June 14th, 2000 blackout that you
6 referred to, was the PUC in any way investigating, looking at,
7 examining, the behavior in the wholesale electricity market?

8 COMMISSIONER LYNCH: Well, we were concerned
9 about what's been called the May 22nd ISO incident, where prices
10 spiked in May. And we were working informally with the
11 Electricity Oversight Board and the ISO to understand what
12 happened.

13 But no, we had no formal investigation to my
14 knowledge.

15 CHAIRMAN DUNN: That example is a very
16 interesting one. Can you briefly described what occurred in the
17 May incident?

18 COMMISSIONER LYNCH: There was -- and I'm doing
19 this from recollection, which one is almost a year ago. There
20 was a price spike that occurred in the wholesale market May
21 22nd. Some, I believe, indicated due to a shortage of
22 electricity.

23 And then the ISO issued a report at some point in
24 June, I believe, regarding that May 22nd price spike, in which
25 they, I believe, mentioned market power, but also discussed how
26 it was just the normal operation of the market rules that the
27 ISO was operating under.

28 But nonetheless, on my watch it was one of the 15

1 first serious signs of the potential and potential exercise of
2 market power in the wholesale market.

3 CHAIRMAN DUNN: And the reason that the PUC is
4 looking at this issue is because of its impacts on the retail
5 market, which is within your jurisdiction?

6 COMMISSIONER LYNCH: Absolutely.

7 If the PUC is going to pass or pass on the donut
8 of retail rates, the big hole in the donut is the cost of
9 wholesale power.

10 CHAIRMAN DUNN: So, in '98, and '99, we've had
11 other witnesses who've appeared before this committee that have
12 testified that there were, in their opinion, signs and symptoms
13 of a dysfunctional wholesale market at that time, but because --
14 I'm assuming, and I know this was prior to your tenure -- but
15 because they were not having a direct impact on retail prices,
16 the PUC was not looking into the issue?

17 COMMISSIONER LYNCH: I believe that to be true,
18 but it was prior to my tenure.

19 CHAIRMAN DUNN: Understood, but your interest was
20 peaked when, all of a sudden, you noticed what was occurring in
21 the wholesale market -- good, bad, or indifferent behavior --
22 that it was going to, or was impacting, retail prices?

23 COMMISSIONER LYNCH: Yes, and of course, that
24 is -- it is also overlaid with the reality of the San Diego
25 situation.

26 Clearly by June, San Diegans were experiencing a
27 sharp increase in price.

28 And I believe at our June 8th, or our early June 15

1 2000 meeting, we addressed some of the impacts on San Diego

2 through allocating some of the revenue bond proceeds that were
3 going to the San Diego customer classes.

4 So, we knew by June, formally as a Commission,
5 that the prices were too high in San Diego.

6 CHAIRMAN DUNN: Understood.

7 And the reason I've been asking those questions
8 is because I want to make sure we're all on the proverbial same
9 page, in that there's lots of things that you do, but the reason
10 that we've asked you come to this committee is because the PUC
11 has engaged and is engaging in an examination of the wholesale
12 electricity market.

13 So, we're basically at the beginning of your
14 examination which, as you indicated, started with the
15 June 14th blackout last year.

16 COMMISSIONER LYNCH: Correct.

17 CHAIRMAN DUNN: Let's walk through that, and I
18 know you had moved ahead already to August. But walk us through
19 what it is the PUC did following that blackout to examine the
20 wholesale market, as well as ultimately, what conclusions were
21 reached by the PUC, and if there's still any ongoing work by the
22 PUC?

23 COMMISSIONER LYNCH: Certainly.

24 On June 14th, there was a supply-related blackout
25 in the PG&E territory. And I frankly don't recall the duration,
26 but there were -- over a hundred megawatts were ordered dropped
27 by the ISO, a firm load, meaning that over 100 megawatts worth
28 of customers were blacked out or lost their electricity.

15

1 Governor Davis, within the next day or two,
2 requested Michael Kahn and I to investigate the causes of those
3 blackouts. So, in a 45-day period, or thereabouts, Michael and
4 I embarked on an intensive investigation and review of the

5 market structures and how the market had failed to provide
6 enough supply.

7 CHAIRMAN DUNN: Again, referring to the wholesale
8 electricity market?

9 COMMISSIONER LYNCH: That's correct.
10 That resulted in what's been called the
11 Kahn-Lynch Report of August 2nd.

12 I would like to underscore that that was not a
13 PUC report. That was a report by two individuals who were
14 appointees of Governor Davis to their respective organizations.

15 And in that report, we outlined the dysfunction
16 of the market and suggested that the deregulation experiment of
17 AB 1890 was not working.

18 We also outlined three sets of suggestions for
19 reform. One, an immediate set of suggestions for the cases of
20 supply inavailability; two, more medium-term suggestions; and
21 three, some longer term suggestions.

22 CHAIRMAN DUNN: Before we move on, Commissioner,
23 you indicated in that report, you and Mr. Kahn concluded there
24 was a dysfunction in that market.

25 COMMISSIONER LYNCH: Yes.

26 CHAIRMAN DUNN: Can you be a little more specific
27 about that?

28 COMMISSIONER LYNCH: Certainly.

15

1 We demonstrated in that report that at that time,
2 by August 2nd, prices were not tracking demand in the California
3 market.

4 Many had argued that, of course, this price
5 increase was just a question of a supply and demand
6 relationship. But we provided examples to show that in fact
7 prices did not correlate to demand in California, and that

8 prices were high all the time, or most of the time, and not just
9 in times of short supply.

10 CHAIRMAN DUNN: Share with us what you examined
11 to reach that conclusion.

12 COMMISSIONER LYNCH: We had requested information
13 from the ISO and from many of the generators in that June-July
14 timeframe in order to aid our report.

15 We did not receive all the information we needed,
16 and the report details, in fact, that we did not receive all the
17 data we needed to do a comprehensive review.

18 But what we did look at was some -- we looked at
19 pricing data and concomitant supply and demand data. Basically,
20 how much demand was there at a particular point in time or a
21 particular day, demand for electricity, and did price track the
22 demand? And we found, in fact, that price did not track the
23 demand, and that there was not a correlation between demand and
24 price.

25 CHAIRMAN DUNN: I'll kind of build two questions
26 in.

27 Share with us what you were not able to get your
28 hands on for purposes of that report, and how was it you were
15

1 able to get access to price data in a relatively short period of
2 time for purposes of that report?

3 COMMISSIONER LYNCH: The Electricity Oversight
4 Board, which oversees the -- or at that point oversaw the ISO,
5 issued subpoenas to the ISO for pricing data. And also, we had
6 demand data from the Energy Commission, and I believe as well
7 from the ISO.

8 So, primarily from the ISO, through the use of
9 EOB subpoenas, we received some data.

10 We had also requested data, I believe -- I don't

11 know if it was through the ISO or directly from the generators,
12 but we requested generator-based data, which we did not receive.

13 CHAIRMAN DUNN: And those requests were made
14 directly to the generators?

15 COMMISSIONER LYNCH: I don't recall whether they
16 were through the ISO to the generators, or to the generators
17 directly.

18 The generators, pursuant to the ISO's tariff,
19 were informed of the data request and were given an opportunity
20 to object.

21 CHAIRMAN DUNN: And it was the subpoena on ISO
22 for this particular information. Do you remember approximately
23 when that was served upon ISO? Rough guess?

24 COMMISSIONER LYNCH: End of June, beginning of
25 July.

26 CHAIRMAN DUNN: Did you embark in one of the
27 usual confidentiality battles at that time?

28 COMMISSIONER LYNCH: I believe so. I'm just 15

1 hesitating because the EOB took the lead on these subpoenas
2 because they were directly overseeing the ISO at that time.

3 CHAIRMAN DUNN: So, that information, we have to
4 go to the EOB for purposes of that information?

5 COMMISSIONER LYNCH: Or we could confer with them
6 and get it to you. I just don't recall the step-by-step data
7 request because they were taking the lead on that.

8 CHAIRMAN DUNN: Understood.

9 Senator Morrow.

10 SENATOR MORROW: May I just interrupt for a
11 second. I want to clarify.

12 Were any requests made for information from FERC?

13 COMMISSIONER LYNCH: At that point, I don't

14 believe so. I believe we were working through the ISO and
15 California-based entities.

16 CHAIRMAN DUNN: We're back to summer. You
17 subpoenaed the information, or the EOB subpoenaed the
18 information from ISO.

19 You got access to that. You had access to --

20 COMMISSIONER LYNCH: To some of it.

21 CHAIRMAN DUNN: -- to some of it. And you got
22 access to the demand information as well.

23 It was really those two sources that led to the
24 issuance of the report?

25 COMMISSIONER LYNCH: That, and collecting all
26 sorts of other kind of academic literature, and other sources.

27 But in terms of data sources, it was primarily
28 those sources.

15

1 CHAIRMAN DUNN: Again, if I could push you on
2 specifics as far as what information you did not get that you
3 wanted?

4 COMMISSIONER LYNCH: You know, we had a long
5 laundry list of information we wanted to get, either from the
6 generators or through the ISO from generator-based information
7 that we actually just never did get.

8 And I believe that our report details that,
9 essentially, the clock ran down, because the Governor had asked
10 us for a report by the beginning of August. So, going into the
11 inquiry, we knew we had 45 days, and so did everyone else.

12 CHAIRMAN DUNN: Which may have been the problem
13 right there.

14 So, the report is issued August 2nd, and you've
15 summarized the report for us very quickly, which we appreciate.

16 Continue for us the efforts of the PUC in

17 examining the wholesale electricity market.

18 COMMISSIONER LYNCH: Certainly.

19 The next day, August 3rd, the Public Utilities
20 Commission had a regularly scheduled meeting, and at that
21 meeting the PUC voted out an order instituting an investigation
22 into the functioning of the wholesale electric market and the
23 associated impact on retail rates.

24 Pursuant so that, we held public hearings in San
25 Diego about the market dysfunctions, where we had economists,
26 and ISO folks, and the PX folks, in to talk about the reasons
27 for the market dysfunctions, and the reasons for the high
28 prices, and reasons why the prices did not correlate to demand.

15

1 And those, I believe, occurred through August and
2 into early September. I recall in the week of September 11th,
3 we had hearings in San Diego, which actually -- or maybe it was
4 actually September 8th, the Friday before that week. So, it was
5 around the time of the FERC and Congressional hearings in San
6 Diego as well.

7 Also, we issued subpoenas pursuant to that
8 investigation on August 18th, on September 20th, and on
9 September 22nd directly to market participants who were
10 generators in California and sellers in California, as well as
11 to the Power Exchange and the ISO.

12 CHAIRMAN DUNN: Let me interrupt you at this
13 point.

14 I want to push you for specifics. Do you have a
15 list of exactly which market participants received subpoenas
16 from you at that time?

17 COMMISSIONER LYNCH: I know on August 18th and
18 September 22nd, we issued subpoenas to: AES Williams, Duke,
19 Dynegy, Reliant, at that point Southern, which is, I believe,

20 now called Mirant.

21 And on September 20th, we issued a subpoena to
22 the Power Exchange.

23 On September 22nd, we issued subpoenas to 57
24 scheduling coordinators who scheduled in our market.

25 And I know that we issued subpoenas to others,
26 but that's what I can recall.

27 CHAIRMAN DUNN: You've raised a term that we have
28 not addressed yet in any of our hearings. Let's define it for
15

1 everybody so we know: scheduling coordinator. Who are they?
2 What do they do?

3 COMMISSIONER LYNCH: There are a variety of
4 entities who schedule the power to be sold in California, I
5 guess simplistically. And those can be a utility; they can be a
6 generator, or a seller, could be a variety of companies who
7 schedule that power.

8 CHAIRMAN DUNN: How do they do that? Where do
9 they serve in this capacity as scheduling coordinators?

10 COMMISSIONER LYNCH: Well, I like to think of
11 them as the middle men between the seller and the ISO and the
12 Power Exchange.

13 CHAIRMAN DUNN: It's an authorized position,
14 basically, isn't it?

15 COMMISSIONER LYNCH: Sure.

16 CHAIRMAN DUNN: Tell us about the response to the
17 subpoenas that you served. Talk both about the market
18 participant recipients as well as the PX and ISO.

19 COMMISSIONER LYNCH: Sure.

20 Concomitant with the September 22nd subpoenas,
21 the assigned law judge -- and it might have been the assigned
22 Commissioner. I don't recall if it was the administrative law

23 judge or the assigned Commissioner -- issued a ruling in that
24 investigation which adopted a protective order about the
25 subpoenaed materials which would keep them confidential.
26 Because when we issued the subpoenas, we, of course, got
27 immediate calls from the various subpoenaed entities' lawyers
28 saying, we're not giving you anything unless it's confidential.

15

1 So, we adopt a protective order which we thought
2 appropriately protected true business confidential information
3 and struck the correct balance between public access and
4 confidentiality of business confidential information.

5 On October 4th, Williams and others moved for
6 modification of the protective order, and we in fact
7 accommodated some of their concerns on October 20th.

8 We, on October 22nd, issued subpoenas to
9 additional scheduling coordinators, and then they continued --
10 we essentially continued an informal meet and confer process
11 through October to try to reach agreement about the scope of
12 confidentiality so we could get the documents. We were unable
13 to do that.

14 On November 2nd, there was interim administrative
15 law judge ruling modifying the protective order and denying all
16 the parties' motions in front of us for additional modification
17 of our protective order. They kept, essentially, pushing us to
18 make more and more confidential before they would discuss with
19 us providing the data.

20 What we realized was, six weeks had gone by, or
21 more, from our September subpoenas to the beginning of November,
22 and we weren't getting anywhere with the entities that we had
23 subpoenaed in terms of getting their documents.

24 So, on November 4th, shortly after the FERC
25 issued their draft order of November 1st, we filed motions to

26 compel the production of documents that we had subpoenaed at
27 FERC, hoping that FERC would help us get access to documents,
28 and building on a conversation I had had in September with
16

1 then-Chairman Hecker, who had offered technical assistance if we
2 were having document and discovery problems.

3 CHAIRMAN DUNN: Chairman Hecker of FERC?

4 COMMISSIONER LYNCH: Of the FERC; that's correct.

5 So, on November 4th, we did go to FERC to move to
6 compel those documents, I believe in part because in August, the
7 FERC also had opened an investigation of their own into the
8 dysfunctions of the California wholesale market. I believe that
9 occurred on August 23rd, that it was around that date that they
10 opened their own investigation.

11 And they had come to California in the week of
12 September 10th, into San Diego, to conduct hearings that I
13 participated in, and my colleague Carl Wood had participated in.
14 So, we had had informal conversations about trying to work
15 together on data access issues.

16 CHAIRMAN DUNN: Ultimately, did you get access to
17 the data you were seeking?

18 COMMISSIONER LYNCH: Well, we have not had a
19 response from FERC to date on our motions to compel. So, we
20 have not received --

21 CHAIRMAN DUNN: I hope you're making a note,
22 Mr. Pease.

23 COMMISSIONER LYNCH: -- from the FERC about those
24 motions to compel.

25 CHAIRMAN DUNN: Mr. Pease, didn't you tell us the
26 FERC would operate -- oh, never mind.

27 I'm sorry, Commissioner Lynch.

28 COMMISSIONER LYNCH: However, the generators

1 continued to -- the folks who we had subpoenaed, primarily the
2 generators, continued to appeal our protective order provisions,
3 first at full Commission on November 16th --

4 CHAIRMAN DUNN: You're referring to the Public
5 Utilities Commission?

6 COMMISSIONER LYNCH: Public Utilities Commission.
7 So, we basically were trying to work with them in
8 good faith to design confidentiality provisions which protected
9 true business confidential information, but also provided access
10 of information that I believed was important to the public
11 debate in a public forum, as the Public Utilities Commission
12 does with information all the time.

13 CHAIRMAN DUNN: And I would assume in those
14 debates, Commissioner, that what we were dealing with was a
15 combination of confidentiality re: traditional trade secrets and
16 the FERC six months confidentiality provision.

17 COMMISSIONER LYNCH: I believe that to be true;
18 that's right.

19 And I don't know specifically if the concerns and
20 comments went beyond trade secrets. I do believe they did. I
21 believe that we had discussions about just the appropriate
22 treatment of what is often referred to as business confidential
23 information, which actually does not rise to the level of a
24 trade secret, which, in my opinion, most of this information, if
25 confidential at all, would fall within the realm of this
26 amorphous business confidential basket, rather than a true trade
27 secret basket.

28 So, we continued to have formal proceedings in
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1 front of the Commission about our scope of our protective order,
2 which the generators and other subpoenaed entities were

3 challenging, as well as seeking relief at FERC who, from our
4 perspective, clearly had jurisdiction had over these market
5 participants.

6 So, this continued on until December 20th. Of
7 course, before December 20th, all sorts of other events had
8 occurred in the California market in parallel. And assigned
9 Commissioner Carl Wood, on December 20th, issued a ruling
10 denying the motions of the generators for further modification
11 of the protective order, and essentially instructed compliance.

12 CHAIRMAN DUNN: This is re: the subpoenas on the
13 market participants?

14 COMMISSIONER LYNCH: Correct.

15 CHAIRMAN DUNN: Where were you at this time with
16 respect to your subpoena on the ISO and the PX?

17 COMMISSIONER LYNCH: We received some data from
18 the PX. I actually think that they were relatively cooperative,
19 and we received some data from the ISO.

20 But it's my understanding that the ISO's process
21 first allowed or required the ISO to go to the generators and
22 see if any of the generators objected to their providing us the
23 information. And if so, then for the ISO to either debate or
24 object with the requesting governmental entity the provision of
25 that information.

26 So, we were receiving some information from the
27 ISO during this period of time, not all the information we were
28 requesting. And some generators actually were more compliant

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1 than other generators with giving us even just basic documents.
2 But certainly, we did not receive compliance, you know, up
3 through the end of December.

4 Although, after Commissioner Wood issued his
5 ruling saying, essentially, "This is it on modifications of the

6 protective order; you will comply," at the very end of December,
7 we started getting the kinds of documents that we were really
8 seeking.

9 And it is true that our subpoenas were pretty
10 comprehensive in the kinds of information we were seeking,
11 because we were trying to do a comprehensive investigation as to
12 the causes of the continuing, at that point, price increases, as
13 well as the supply shortages that we had been experiencing in
14 December.

15 Intervening events, essentially, dove-tailed with
16 our document needs, in that we experienced, I believe on
17 December 7th, a Stage Three emergency, and the PUC dispatched
18 our inspectors to go to the plants who were experiencing forced
19 outages. And in doing that, we were requesting additional
20 information from the those plants regarding maintenance records,
21 operation logs, and the like.

22 CHAIRMAN DUNN: Something you believe rests
23 within the authority of the PUC?

24 COMMISSIONER LYNCH: Absolutely.

25 Of course, the generators who were experiencing
26 those forced outages were certainly -- complained to the Public
27 Utilities Commission that we were not authorized to inspect
28 their plants, and they wanted, before they gave us any logs or
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1 that kind of information, assurances that those logs would be
2 kept confidential according to their specifications. And that
3 occurred all through January, we had that debate and discussion
4 with those generators.

5 CHAIRMAN DUNN: Let me interrupt again. Let's
6 get in a little more specifics.

7 How many plants are we talking about,
8 Commissioner?

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9 COMMISSIONER LYNCH: You know, I don't have that
10 data at my finger tips, but I'd be happy to provide it. I don't
11 recall specifically.

12 But we did go to -- essentially, on December 7th,
13 there were historic numbers of megawatts out for unplanned
14 outages or forced outages. Certainly many more than had been
15 the case either the year before, or when the utilities owned
16 those very same plants.

17 So, we wanted to understand the causes of those
18 forced outages because they were at such historic levels. So
19 whatever plants we understood to be out, not on a planned,
20 routine maintenance basis, but on a forced outage basis, we
21 wanted to understand those causes. And whatever those plants
22 were on that day are the plants that I'm referring to.

23 CHAIRMAN DUNN: Understood.

24 Senator Bowen.

25 SENATOR BOWEN: I think the term forced outage is
26 often confusing to people.

27 Could you explain to us what a forced outage is?

28 COMMISSIONER LYNCH: Certainly.

16

1 I liken it to taking your car into the shop. You
2 can set a schedule of routine maintenance and regular
3 maintenance, and those are planned outages.

4 The plants come down for planned maintenance at a
5 variety of set times, and they notify the ISO that they're going
6 to be down, and they're taken off line for repairs and
7 maintenance.

8 There are other plants that are not scheduled in
9 advance. And those plants are taken off line for a variety of
10 reasons. I think the common terms is either forced or unplanned
11 outage. So, they're not on the planned maintenance schedule

12 that everybody knows about, and the ISO can plan for in their
13 dispatch.

14 SENATOR BOWEN: It doesn't mean that somebody
15 forced them to stop generating. It signifies that some
16 unexpected or unplanned -- it's the opposite of a planned event?

17 COMMISSIONER LYNCH: It's the opposite of a
18 planned, duly notified maintenance or repair outage.

19 SENATOR BOWEN: We use the term unforced outage,
20 which presumably would mean, you know, you just didn't feel like
21 generating that day. But it really means unplanned as opposed
22 to a planned or scheduled.

23 COMMISSIONER LYNCH: Right. It's an unscheduled
24 outage. And they could have a variety of reasons for an
25 unscheduled outage. Your point's well taken.

26 SENATOR BOWEN: Nobody's required to report to
27 you as to why there was an outage?

28 COMMISSIONER LYNCH: No.

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1 SENATOR BOWEN: Even if it's a reliability
2 must-run plant?

3 COMMISSIONER LYNCH: They report to the ISO.

4 SENATOR BOWEN: Do they have to report the
5 reason?

6 COMMISSIONER LYNCH: I know the ISO obtains
7 reasons in many respects. I am not actually not recalling
8 whether or not that's required.

9 CHAIRMAN DUNN: Commissioner, before you go on,
10 with respect to the plant visits.

11 COMMISSIONER LYNCH: Yes.

12 CHAIRMAN DUNN: Did you encounter cooperation
13 from all of the plants that were visited?

14 COMMISSIONER LYNCH: No. There was a wide range

15 of response to the plant visits.

16 And I'd like to distinguish between the few plant
17 visits we had in December, when there was a Stage Three
18 emergency, and the plant visits that the PUC began on a regular
19 basis in January.

20 After the Governor's State of the State Address,
21 where he indicated that the PUC would obtain additional
22 inspectors to check on these unscheduled outages, the PUC began
23 going to the plants that were down for unscheduled reasons on a
24 routine basis.

25 What we found first was that not all of those
26 plants had duly notified the ISO that they were down.

27 CHAIRMAN DUNN: Which is required.

28 COMMISSIONER LYNCH: I would think that the ISO
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1 would need to know which plants are going to operate, if they
2 had said that they were going to operate, and then they weren't.
3 I'm not recalling the specific tariff provision, but certainly,
4 those plants that are reliability but must run, or other kinds
5 of plants. If it's not required, it should be.

6 So, we would go to unscheduled plants, or the
7 plants that had unscheduled outages on a routine basis,
8 beginning mid-January. At that point, some of the generators
9 were resisting our coming onto their premises and inspecting
10 their plants on a routine basis.

11 CHAIRMAN DUNN: How did that unfold? When you
12 say "resisting," what do you mean?

13 COMMISSIONER LYNCH: They would question our
14 authority to be in. In a few instances, I believe, the person
15 at the gate said, "No, you can't come," and then we would
16 essentially kick that up to the lawyers to discuss.

17 Eventually, many of the generators required

18 advance notice for us to come into their plant. And at least
19 one of the generators requires -- sends someone around with us
20 as we inspect the plant.

21 CHAIRMAN DUNN: There's been a description in
22 previous testimony at a prior hearing that determining the
23 legitimacy of unplanned outages is a bit like the employee who
24 calls in saying, "I have an upset stomach." That it's very
25 difficult to prove or disprove the ailment, and in this case,
26 what the cause of the outage was.

27 Do you share that view?

28 COMMISSIONER LYNCH: Absolutely, especially for
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1 those plants that don't notify the ISO that they're down. We
2 have to call them, and then obviously they know when we call,
3 we're coming. So, by the time we get there, you now, if the fan
4 -- if the reason is the fan wasn't working, you can pretty much
5 be assured that by the time we get there, the fan in fact is not
6 working.

7 CHAIRMAN DUNN: And the bases for the demand of
8 advanced notice by certain generators came from where?

9 COMMISSIONER LYNCH: Well, that's a good
10 question. I think that they're basically just saying, "If you
11 want to be here, we have a right to reasonable notice."

12 CHAIRMAN DUNN: And what is that reasonable
13 notice that was determined?

14 COMMISSIONER LYNCH: What we do, I believe, is,
15 we call them and say, "Are you down? We're coming."

16 CHAIRMAN DUNN: There's not a time constraint of
17 two hours, two days notice?

18 COMMISSIONER LYNCH: No, I don't believe so.

19 CHAIRMAN DUNN: Just some advanced notice before
20 you show up at our front door.

21 COMMISSIONER LYNCH: That's correct.

22 And different generators are taking different
23 positions on our ability and authority to be there.

24 But certainly by January 19th, many of the
25 generators were definitely challenging our authority. And in
26 fact, on January 19th, many of the generators filed a petition
27 for a Writ of Mandate and an emergency request for stay of our
28 confidentiality provisions in the Court of Appeal. We were 16

1 going after documents that we would get when we went to plants.

2 CHAIRMAN DUNN: So, part of that petition that
3 was filed was designed to stop the PUC from making these site
4 visits?

5 COMMISSIONER LYNCH: No, it was really from
6 obtaining documents either at the site, or the documents from
7 our original subpoenas.

8 CHAIRMAN DUNN: They're basically trying to stop
9 access to any documents, whether it's through site visits or
10 through your document requests, subpoenas, et cetera.

11 COMMISSIONER LYNCH: Well, any may be broad, but
12 certainly, certain documents.

13 CHAIRMAN DUNN: I want to get into a little bit
14 of where the status is of that particular petition.

15 But before we do that, when you first served that
16 subpoena on the ISO, and I know we're talking about last fall, I
17 believe it was.

18 COMMISSIONER LYNCH: Yes.

19 CHAIRMAN DUNN: What sort of response did you get
20 from the ISO at that time to your subpoena?

21 COMMISSIONER LYNCH: I know that they first sent
22 it around to their participating market participants to see if
23 any of them had objections.

24 We eventually worked out our issues with ISO, but
25 it took several months.

26 CHAIRMAN DUNN: Ultimately resolved?

27 COMMISSIONER LYNCH: Yes.

28 CHAIRMAN DUNN: And did you get everything that
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1 you were entitled to from the ISO?

2 COMMISSIONER LYNCH: I believe once the
3 composition of the Board of Directors of the ISO changed, we
4 did.

5 CHAIRMAN DUNN: And prior to that, no.

6 COMMISSIONER LYNCH: You know, I'm not certain
7 about when exactly we received all the data. I would need to
8 check with my attorneys who were individually involved with the
9 ISO.

10 CHAIRMAN DUNN: The reason I asked that question
11 is, at least my interpretation of your answer was that the
12 willingness to cooperate may have had something with the change
13 in membership of the ISO Board.

14 COMMISSIONER LYNCH: From my perspective, the ISO
15 has become more much cooperative now that Board members are
16 independent of market participants.

17 CHAIRMAN DUNN: Can you briefly explain that for
18 us that are here this afternoon.

19 What was the ISO Board? What did it consist of
20 before that change, and what is it after that change?

21 COMMISSIONER LYNCH: Before mid-January of this
22 year, the ISO had a 26 or 27 member Board. Senator Bowen
23 probably knows more specifically, oh, 25. I guess I'm thinking
24 of 27 because the EOB and the PUC were ex-officio members.

25 Anyway, a board in the twenties, which was
26 composed of a variety of market participants, consumer

27 representatives, I believe an environmentalist, the League of
28 Women Voters, the utilities. But it was a board that was what
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1 they call a stakeholder board. People who had a stake in the
2 decisions of the ISO.

3 CHAIRMAN DUNN: That was pre-January?

4 COMMISSIONER LYNCH: Yes.

5 CHAIRMAN DUNN: Post January?

6 COMMISSIONER LYNCH: Then AB 6X -- 5X.

7 CHAIRMAN DUNN: I can't remember the number
8 either.

9 COMMISSIONER LYNCH: They were passed on the same
10 day, and I'm right now just blank on which was the retained
11 generation bill, and which was the ISO reform bill.

12 But the Keeley bill changed the composition of
13 the ISO to require a five-member board appointed by the Governor
14 who needed to be independent of the market participants.

15 When that Board was seated, I noticed a marked
16 change in the cooperation provided by the ISO on all sorts of
17 levels.

18 CHAIRMAN DUNN: What happened to the PX at that
19 time?

20 COMMISSIONER LYNCH: The PX was in the process of
21 shutting down. So, we were continuing to obtain documents from
22 the PX, and we did obtain the documents that we needed from the
23 PX through that January-February period.

24 CHAIRMAN DUNN: For those that are not familiar
25 with why, why did the PX shut down? We had a long discussion
26 with the State Auditor this morning about the PX role, and the
27 ISO role. And purchases in the ISO market were markedly higher
28 than the PX market.

1 Why was the PX shut down?

2 COMMISSIONER LYNCH: I believe that in the FERC's
3 December 15th order, it ordered the PX to kind of cease its
4 existence as of the particular date in time.

5 I don't know if those were the words they used,
6 but that was the effect.

7 CHAIRMAN DUNN: So, basically it was FERC
8 initiated?

9 COMMISSIONER LYNCH: That's my opinion, yes.

10 CHAIRMAN DUNN: We can explore that with
11 Mr. Pease as well.

12 We've talked about the subpoenas that you've
13 issued once you commenced investigation, beginning the summer of
14 2000. We talked about the plant visits.

15 What other steps have you taken to investigate
16 the wholesale electricity market in California?

17 COMMISSIONER LYNCH: We have obtained -- what
18 we've done is, we've hired experts to analyze the data, which is
19 both the bid data, the sales data, various plant data, and
20 pricing data. And we have worked in conjunction with the
21 Attorney General's Office on that analysis.

22 So, between the Attorney General's Office and the
23 Public Utilities Commission, we have had a team of lawyers,
24 economists, and analysts certainly since December to analyze the
25 data that was coming in and determine, or basically try to
26 figure out what that data showed us about the operation of the
27 market and of particular participants in the market.

28 CHAIRMAN DUNN: So, we've got the subpoena for
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1 information. The fights over those subpoenas. We've got the
2 plant visits. We've got the retention of experts, consultants,
3 to analyze that data, some of which are working in conjunction

4 with the Attorney General's Office.

5 What other investigative steps are either
6 underway or anticipated, if you can share them with us?

7 COMMISSIONER LYNCH: Well, on an informal basis,
8 we've certainly coordinated with the EOB's analysis.

9 And as a response to the FERC's November 1st
10 draft order, where the FERC requested or required all
11 commentators on the draft order to file comments by
12 November 22nd, various state entities, and also various other
13 economists, for instance, I recall Dr. Wolak of Stanford,
14 submitted analyses and evidence in those November 22nd filings.

15 So, we certainly worked informally with various
16 other submitters regarding market power analyses.

17 And in addition, although this isn't formally a
18 parts of the investigation that the PUC is conducting, that's
19 underway at the PUC, the PUC had additional market power
20 analysis in another one of its proceedings, in the PG&E hydro
21 divestiture proceeding, which helped inform our November 22nd
22 FERC filings and our other investigations.

23 CHAIRMAN DUNN: Anything else we're missed as far
24 as the efforts within the investigation the PUC has undertaken?

25 COMMISSIONER LYNCH: Not that I can think of.

26 Basically, it really is focused on a pricing
27 behavior analysis, which is a larger analysis that's underway
28 with the Attorney General, and then smaller but related the

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1 physical withholding analysis which relates to the plant
2 outages, which we're also doing in conjunction with the Attorney
3 General, but which really is kind of a separate effort.

4 CHAIRMAN DUNN: Let's talk for a few minutes
5 about conclusions thus far, findings thus far, that you can
6 share with us, please.

7 COMMISSIONER LYNCH: I would note in response to
8 one of your prior questions, you asked where are we with
9 documents.

10 Certainly, the generators filed a petition for
11 Writ of Mandate, an emergency request of stay of our ACRs on
12 January 19th.

13 On January 25th, the California Court of Appeal
14 dismissed those petitions. And then on January 25th, that same
15 day, the generators filed a petition for Writ of Review with the
16 California Supreme Court.

17 Now, through this time, the PUC had provided
18 written assurance that we would treat in confidential manner
19 documents that we would -- in the same manner that we would
20 great documents supplied by regulated entities under Public
21 Utilities Code Section 583. But that apparently wasn't good
22 enough.

23 And then, after the generators went to the
24 California Supreme Court, the California Supreme Court denied
25 that petition for a writ on March 14th of this year. So, they
26 took it all the way up to the California Supreme Court.

27 And we continue, frankly, to refine our data
28 requests and to inspect the plants during forced

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1 outages.

2 CHAIRMAN DUNN: Given the denial by the Supreme
3 court, what happened after that? Did you get what you were
4 looking for?

5 COMMISSIONER LYNCH: We are now getting
6 substantially more documents from the market participants that
7 we had subpoenaed, yes, as of that February-March timeframe.

8 CHAIRMAN DUNN: All right. Appreciate the update
9 on that, because I forgot to come back to do that follow-up.

10 Let's get to the status of your investigation,
11 findings, conclusions, if any, that have been reached thus far.

12 COMMISSIONER LYNCH: Certainly.

13 You had asked me to testify today regarding the
14 status of the PUC's investigation of physical withholding and
15 economic withholding.

16 I'd like to focus my remarks on the physical
17 withholding side of that. There is larger ongoing investigation
18 regarding the economic pricing issues that I would not be
19 prepared to speak to, except to say that that is ongoing. It's
20 a very large effort which has been hampered by the lack of full
21 documents over this six-month period. But I believe it's in
22 full gear, now that we are receiving the amount of documents
23 that we are.

24 CHAIRMAN DUNN: Understood.

25 COMMISSIONER LYNCH: The PUC is conducting this
26 investigation of physical withholding, which takes place at the
27 fossil fuel generation units, those units over 50 megawatts that
28 are located within California's borders. These are the same

17

1 fossil fuel generation units that were ordered divested from the
2 state's public utilities in order to provide -- to comply and
3 comport with Commission orders and the intent of AB 1890.

4 The PUC's investigation is being conducted
5 pursuant to Government Code provisions and protective orders
6 that require the PUC to protect the confidentiality of
7 information while the investigation's ongoing. So, therefore,
8 specific information that the PUC has obtained regarding the
9 operation of certain generating units must still be kept
10 confidential at this time.

11 So, while I cannot reveal the particulars of
12 information that the PUC has obtained regarding specific

13 generation units, I can tell you generally that it appears that
14 there has been numerous instances within the past half-year
15 where generation units were not producing the amount of
16 electricity that they were capable of producing. Or that they
17 were not producing the amount of electricity that the generator
18 was instructed to produce by the California ISO.

19 I believe that that failure to produce energy
20 that was available or capable of production has contributed to
21 California's experiencing Stage One, Stage Two, and Stage Three
22 emergencies.

23 Our investigation has revealed no legitimate
24 maintenance or repair reason at concern points in time for those
25 units not to be running at capacity, and the capacity was called
26 for by the California ISO.

27 I also believe that one of the results of the
28 supply of power not being provided was to contribute to the spot
17

1 price per megawatt for electricity to contribute to a
2 substantial increase in those spot prices. In many instances,
3 the generation units that had been not producing what they were
4 capable of were then either brought back on line, or were ramped
5 up to increase production capacity to generate more output.
6 And, of course, if that spot price was higher, then that power
7 would then be sold at the higher prices that could be charged
8 during a declared State One, State Two, or State Three
9 emergency.

10 I've brought particular charts that demonstrate.
11 It's really just to provide an illustrative example of the kinds
12 of things we're seeing.

13 CHAIRMAN DUNN: And I think we're ready to go on
14 the overhead. Where did Alex go? She's missing here.

15 COMMISSIONER LYNCH: What I would say is that I

16 think that the behavior that we're seeing varies in many
 17 respects, but all comes to some of the same points, which is
 18 that generators in California who are in charge of their own
 19 plants have the ability to produce or not produce, and that
 20 those decisions to produce or not produce do affect the price in
 21 California.

22 I would just direct the committee's attention to
 23 a quote from an executive of Reliant Industries, where he said
 24 in 1997 something, I think, that is very instructive to us
 25 today, because I believe that it's the application of a
 26 strategy that he described in 1997. And it's that application
 27 of the strategy that we're experiencing in California's market.

28 So, with your consent, I'd like to just read you
 17

1 the quote from Mr. Charles Oglesby, where he said in Public
 2 Utilities Fortnightly on November 15th, 1997, the following.
 3 Quote:

4 "We have a lot of experience
 5 dealing with summer peaks and
 6 dispatching plants. When you
 7 operate on emergent basis and
 8 sell into a power exchange, you
 9 can watch the price climb during
 10 the day. We might decide to hold
 11 our plant off the market at 12:00
 12 noon, even if the price looks
 13 favorable, because we can get a
 14 better price at 4:00 P.M. We
 15 think we know a little bit about
 16 what will happen if we hold our
 17 plant out few hours. We can play
 18 on that expertise."

19 End quote.

20 CHAIRMAN DUNN: Where was that statement
21 made?

22 COMMISSIONER LYNCH: In Public Utilities
23 Fortnightly on November 15th, 1997. And that's quoting then
24 Houston Industry's executive, Charles Oglesby, and is Reliant's
25 predecessor.

26 CHAIRMAN DUNN: If you could, just read it one
27 more time for us.

28 COMMISSIONER LYNCH: Certainly. Quote:

17

1 "We have a lot of experience dealing
2 with summer peaks and dispatching
3 plants. When you operate on a merchant
4 basis and sell into a power exchange,
5 you can watch the price climb during
6 the day. We might decide to hold our
7 plant off the market at 12:00 noon,
8 even if the price looks favorable,
9 because we can get a better price at
10 4:00 P.M. We think we know a little
11 bit about what will happen if we hold
12 our plant out a few hours. We can play
13 on that experience."

14 And I believe certainly that many generators are
15 playing on their experience, and playing at the expense of
16 Californians.

17 CHAIRMAN DUNN: Are we ready to set up the
18 overhead here.

19 COMMISSIONER LYNCH: The charts that we have
20 today are from the November timeframe. I chose the November
21 timeframe advisedly because that is outside the ISO's six-month

22 confidentiality window.

23 Now, there's additional data, obviously, that we
24 have relating to particular generators and particular days which
25 I'm not sharing with the committee today because of
26 confidentiality issues.

27 CHAIRMAN DUNN: Commissioner, the issue of there
28 is certain data that you can't share because of confidentiality
18

1 provisions.

2 From your interpretation of those provisions, are
3 you even precluded from identifying what type of data we're
4 talking about, as opposed to the content of that data?

5 COMMISSIONER LYNCH: I believe that the data I'm
6 sharing today is from the ISO, and it's outside the six-month
7 confidentiality --

8 CHAIRMAN DUNN: No, my question actually was, the
9 data you can't share today because of confidentiality
10 provisions. The question is -- and I'm not asking you to detail
11 it right now; we can follow up -- do you have an opinion as to
12 whether you can actually identify the categories of that data,
13 as opposed to the actual contents of the data?

14 COMMISSIONER LYNCH: I think that's a good
15 question that I would need to reflect on for a minute.

16 CHAIRMAN DUNN: Okay.

17 Why don't we go to your graphs here.

18 COMMISSIONER LYNCH: The first chart shows that
19 output from this particular generating unit was reduced, and we
20 can find no maintenance reason for that reduction. And you can
21 see, it's the black line that's below the bar. So, at a
22 particular hour of the day, the plant was operating at full
23 capacity, and then it was reduced.

24 Thereafter, after that plant was essentially

28 day, November 15th. The next day, what this shows is a unit 18

1 sharply increasing its output after a Stage One alert was
2 called, but then unexpectedly dropping its output, only to begin
3 increasing again just before a Stage Two alert was called. And
4 then it increases slowly, parallel to an increase in the spot
5 market price, to drop again after Stage One ended.

6 Then the next slide is also from November 14th.
7 And this chart shows a unit that was producing near capacity,
8 then dropping sharply until a Stage One and then a Stage Two
9 were called, and the unit then increased production to full
10 capacity in a curve that directly paralleled the increase in the
11 spot market price, only to fall again after the Stage Two alert
12 ended and the spot price began to decline.

13 That's a unit that's a different unit from the
14 unit showed you on the same day on November 14th.

15 The final chart is also from November 14th. That
16 chart shows an RMR unit dropping production sharply right before
17 a Stage One, then increasing it as first a Stage One and then a
18 Stage Two alert were called, as they were probably required to
19 increase. The ISO probably called them as an RMR unit after the
20 Stage One was called.

21 CHAIRMAN DUNN: We haven't gone into any real
22 description today at least of RMRs. Just briefly describe that
23 for us.

24 COMMISSIONER LYNCH: It's a reliability must-run
25 plant, which has an arrangement or a contract with the ISO to
26 run when called, if it's able to.

27 But here it shows that, in fact, earlier in that
28 day, it was clearly able to run, did run at a higher capacity, 18

1 dropped its capacity before Stage One was called, to ramp up

2 again after Stage One and then Stage Two was called.

3 Of course, that ramp up corresponds with a sharp
4 increase in the spot market price as well.

5 So, this is really just an illustrative example
6 of three different generating units on the same day which all
7 had similar behavior, which was to run at a particular level,
8 then to drop. The drop occurred certainly not at the exact same
9 time, but in the same time frame. Less power was available in
10 California. A Stage One was called. They'd ramp back up. The
11 price would increase, and obviously, you know, to the extent
12 that they were running at a higher level, they would be
13 receiving an increased price.

14 CHAIRMAN DUNN: To generate these charts,
15 basically all you're doing is comparing the price, the top line
16 here on this particular chart, with the generation-specific
17 production information?

18 COMMISSIONER LYNCH: Correct. And then
19 understanding the capacity of that plant in particular, and just
20 picking a day that's outside the six-month ISO confidentiality
21 range.

22 CHAIRMAN DUNN: Understood.

23 And the straight red line in each of the charts
24 is the capacity of the specific plant we're referring to?

25 COMMISSIONER LYNCH: Correct.

26 So, this doesn't provide a complete overview of
27 the kinds of information we're finding, but it certainly does
28 provide a snapshot on a given day where a Stage One and Stage
18

1 Two were called in California in which prices increased sharply,
2 and the confluence of activity by individual generating units.

3 CHAIRMAN DUNN: If we go back six months from
4 today, I think that would take us to approximately late November

5 of last fall.

6 Have you done any further of these types of
7 comparison in any other dates prior to late November of last
8 year?

9 COMMISSIONER LYNCH: I believe we have.

10 CHAIRMAN DUNN: Are your findings any different
11 than the snapshots that you've shown here today?

12 COMMISSIONER LYNCH: Well, there are different
13 activities, but we certainly see a pattern of individual plants
14 operating at a particular level of capacity, reducing that
15 capacity for a reason which we cannot explain by our review of,
16 you know, maintenance issues or repair issues. And then, at the
17 beginning of a shortage, after those reductions, then increasing
18 capacity and certainly increasing the price they're paid for
19 that generation.

20 CHAIRMAN DUNN: The bidding data that you've got
21 here of what the market price was, the top line, that in itself
22 on a day-to-day basis, even yesterday, isn't confidential
23 information.

24 COMMISSIONER LYNCH: I don't believe
25 so. However, in order to get data from the ISO, we agreed to
26 the rules of the ISO.

27 CHAIRMAN DUNN: I understand.

28 What I'm really trying to do is not probe beyond
18

1 where you want to go, Commissioner, but for our own parameters,
2 that bidding price line, the top line, at least in my view,
3 reflects information that's not within the confidentiality of
4 the FERC tariff. I mean, that would be my guess. You can
5 obtain that day-to-day, what was the price that electricity was
6 being sold at on a given day without generator-specific
7 information.

8 Am I incorrect about that?

9 COMMISSIONER LYNCH: You know, I'm just pausing
10 because the rules have changed so much over the last six months.
11 I would hesitate to characterize the rules.

12 And frankly, I receive a lot of that information.
13 There's so much information I receive that's confidential, in my
14 mind I'm over-active in keeping as much confidential as
15 possible.

16 CHAIRMAN DUNN: And the production levels of a
17 given generation asset here in California, does anyone, any
18 regulatory body -- FERC, PUC, et cetera -- collect that data on
19 an ongoing basis?

20 COMMISSIONER LYNCH: We do not collect that data
21 on an ongoing basis. I frankly don't know if FERC does.

22 CHAIRMAN DUNN: So that that information would
23 have to come from, in all probability, generator-specific data
24 requests. We've got to go to the generator that owns that plant
25 to get that information.

26 COMMISSIONER LYNCH: And potentially the ISO.

27 CHAIRMAN DUNN: And the ISO may have it as well?

28 COMMISSIONER LYNCH: I would think the ISO would
18

1 have that, because they know how much -- how many megawatts
2 they're putting into the system from a particular generator.

3 CHAIRMAN DUNN: At any given time?

4 COMMISSIONER LYNCH: I believe so. That's how
5 they run the grid.

6 CHAIRMAN DUNN: And I know that you're not from
7 the ISO, and you don't know exactly the application of the
8 confidentiality as to that information on the bottom line?

9 COMMISSIONER LYNCH: I believe because it's from
10 November 14th, it falls outside the ISO parameters, the

11 six-month parameters.

12 CHAIRMAN DUNN: And my question, and I wasn't
13 clear enough, within the six-month period, that's something
14 we're going to have to find out from the ISO?

15 COMMISSIONER LYNCH: Correct.

16 CHAIRMAN DUNN: Have you done, that is the PUC in
17 its investigation, or in conjunction with the Attorney General's
18 Office, an examination of this type of data within the past
19 six-month period?

20 COMMISSIONER LYNCH: Yes, and this data also has,
21 obviously, other overlays that you can do when you analyze this
22 data in conjunction with other data that remains confidential.

23 CHAIRMAN DUNN: Can you give us an example,
24 without providing data. Let's just do a hypothetical example.
25 What other overlays are you referring to?

26 COMMISSIONER LYNCH: Maintenance and operations
27 logs. What's occurring at that plant at the time.

28 CHAIRMAN DUNN: Meaning that if we took a

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1 hypothetical overlay on this information, we'll look at how this
2 particular plant ramped down at it looks like early afternoon.
3 Maintenance logs may show that there was no maintenance reason
4 for that ramp down information. That's the type of situation
5 you're referring to?

6 COMMISSIONER LYNCH: Correct.

7 CHAIRMAN DUNN: And within the past six months,
8 have you done such overlays for the past six-month period?

9 COMMISSIONER LYNCH: Within the past six months,
10 we have.

11 I would say we are not finished with our
12 investigation to date of all of that data, and we certainly
13 don't have all of that data for the most recent months, but we

14 have substantial data at this point, and we're continuing our
15 analysis on a comprehensive basis of all the data we have.

16 CHAIRMAN DUNN: What about prior to the past six
17 months. Have you done, beyond this snapshot day that we've
18 done, or these few charts, have you done more of an examination
19 of time periods prior to late November of last year?

20 COMMISSIONER LYNCH: We have substantial data
21 from the fall. And I frankly don't recall when our
22 comprehensive analysis starts. We just picked a date in time,
23 based on some protocol criteria that we developed.

24 So, what we wanted to do was look at the busiest
25 times in terms of shortage, basically. And that's what we're
26 focusing on.

27 CHAIRMAN DUNN: Understood.

28 And if one of those times existed prior to late
18

1 November of last year, is that then publicly available
2 information through the PUC?

3 COMMISSIONER LYNCH: It depends on the data, but
4 I believe the ISO-obtained data that falls outside that
5 six-month framework would fall outside the six-month
6 confidentiality framework, yes.

7 I know that our emphasis has been November
8 forward, but we may well have done additional analysis on
9 pre-November periods.

10 CHAIRMAN DUNN: All right. We'll probably follow
11 up with you after this particular hearing to see in, if fact,
12 that's been done, and whether it's available public, or whether
13 we've got to wrestle with ongoing confidentiality problems.

14 COMMISSIONER LYNCH: Certainly.

15 I just provide these charts as an example of the
16 kinds of analysis that the PUC is undertaking. We are by no

17 means finished with that analysis, and are working in
18 conjunction with the Attorney General on our analyses.

19 CHAIRMAN DUNN: Question for you. With respect
20 to these particular charts, since we're outside the six-month
21 period, can you identify the generator that's at issue in these
22 charts?

23 COMMISSIONER LYNCH: No.

24 CHAIRMAN DUNN: And the reason for that?

25 COMMISSIONER LYNCH: Because while the data in
26 aggregate may be public, it's my understanding that the
27 generators and the ISO are taking the position -- and I have to
28 check on the ISO's current position on this point -- that

18

1 generator-specific information is not public.

2 CHAIRMAN DUNN: I know we're talking about a
3 different body other than the PUC here.

4 Do you know why they're taking that position?
5 What's the basis for taking that position?

6 COMMISSIONER LYNCH: I have no idea. I mean,
7 this is six-month-old information.

8 CHAIRMAN DUNN: Right, that's why we're asking
9 the questions. It would seem that, why can't we put the Acme
10 Corporation, or whoever it may be, on there if it's in fact over
11 six months old?

12 So, you believe you're bound by other
13 confidentiality provisions or agreements that preclude you
14 identifying the generator in question here.

15 COMMISSIONER LYNCH: I would say we have a
16 variety of confidentiality provisions we've agreed to, to get
17 data, as well as, we are respecting the ISO's tariffs in the
18 data they have given us, as well as, we are, of course,
19 respecting the PUC's rules, and our protective order that we

20 issued in this investigation.

21 I would say we are being conservative in our
22 analysis and approach to this because we're not done. And
23 obviously, we don't want someone to cut off our access to data
24 in any kind of retaliation for discussing what may or may not be
25 truly appropriately public information.

26 CHAIRMAN DUNN: Can you share with us who the
27 consultants, experts, et cetera, are retained by the PUC? Is
28 that publicly available information?

19

1 COMMISSIONER LYNCH: Yes, and in fact, we've
2 provided that to, I believe, both budget committees of the
3 Assembly and the Senate, a list of our consultants, not only in
4 this investigation, but also more broadly, our auditors, our
5 bankruptcy counsel, our other specialized counsel.

6 CHAIRMAN DUNN: As far as consultants, experts,
7 for examining the bidding data, that sort of thing, who is it
8 that you are using for that purpose?

9 COMMISSIONER LYNCH: We are using Isenstat's
10 firm, and I'm blanking on the name of the firm. But he's kind
11 of an analytical consultant who the PUC has used in plant outage
12 investigations in the past.

13 As well as, we're using several individual
14 consultants who have worked at plants, and in many instances, at
15 particular plants in California. And I just don't have that
16 list with me, but I'd be happy to provide that when I get it
17 from my office.

18 Basically, these are folks who have worked at
19 these plants in operations, and have considerable experience in
20 analyzing both bid data as well as operational data of how
21 plants operate.

22 CHAIRMAN DUNN: Within the course of your

23 investigation thus far, have you reached any conclusions
24 regarding the existence of potential market power or the actual
25 exercise of market power in the California wholesale electricity
26 market?

27 COMMISSIONER LYNCH: I hesitate on that point
28 because we're not finished. But clearly, there are many

19

1 instances in which decisions have been made not to provide power
2 to the California market that was otherwise available, we
3 believe, to be produced. And as a result of those decisions,
4 the price increased that we all paid.

5 Now, you know, it depends on your definition of
6 market power, but clearly, an ability for folks to ramp down and
7 thereafter have a Stage One in California, which would ramp up
8 the price, in my book certainly affects market power.

9 I do want to be clear that the analysis I'm
10 presenting today is an analysis of individual unit behavior. And
11 this example was just three different units who all happened to
12 be producing at a particular level, ramped down, and then ramped
13 up.

14 But I'm not drawing any connections between those
15 individual unit's behavior.

16 CHAIRMAN DUNN: In the analysis of the
17 FERC-ordered staff report of November last year, I just want to
18 read you one paragraph. We don't have to go into it itself. It
19 says:

20 "The CPUC staff preliminary
21 analysis of the facts examined by
22 FERC suggest that market power was
23 exercised to a very substantial
24 degree over the past six months
25 and that further investigation is

26 absolutely necessary. "

27 Do you recall that?

28 COMMISSIONER LYNCH: Yes.

19

1 CHAIRMAN DUNN: That was in November. Has there
2 been any further investigation by the PUC with respect to market
3 power?

4 COMMISSIONER LYNCH: Yes. I believe both in the
5 context of this investigation that I'm kind of demonstrating a
6 snapshot on, and then generally in terms of following up on our
7 analysis of our comments of November 22nd.

8 CHAIRMAN DUNN: You mentioned, obviously it
9 depends on definition of market power, and we've had that
10 discussion with a number of witnesses, and we're deeply
11 ingrained in it with Mr. Pease earlier.

12 I want to read to you, it's very short, the
13 Department of Justice guidelines in defining market power.
14 It's, quote, "the ability profitably to maintain prices above
15 competitive levels for a significant period of time," end quote.

16 Is that a fair description of how the PUC is
17 looking at the concept of market power?

18 COMMISSIONER LYNCH: I believe so.

19 And it also depends on the period of time. I
20 don't think that you have to have one entity controlling market
21 price over days or weeks. You can certainly have a confluence
22 of events and circumstances in which, in one event, one entity
23 can control, and in another event, another entity can control.
24 And that, in my book, is still market power.

25 CHAIRMAN DUNN: In other words, if I can reduce
26 that to lay terms, Commissioner, that there are situations
27 within the market that I may have the ability to exercise market
28 power today, but I may not have it tomorrow. I may have it back

1 the day after tomorrow, depending upon a number of
2 circumstances?

3 COMMISSIONER LYNCH: Correct.

4 But the end results for the California consumer
5 is still too high a price.

6 CHAIRMAN DUNN: Now, we've had earlier witnesses
7 talk about, if we just make the assumption that there was an
8 exercise of market power in the California wholesale electricity
9 market, that the next question is whether there was a market
10 power exercised in a concerted/collusive fashion.

11 Has your investigation explored into that area in
12 any degree?

13 COMMISSIONER LYNCH: Yes, that's still an ongoing
14 question at this point, to which we have not drawn a conclusion.

15 CHAIRMAN DUNN: Again, I want to read, and we
16 don't have to go to it, but Page 26 of that late November
17 analysis that the PUC prepared. It says:

18 "It is the CPUC's contention that
19 the western electric power
20 industry does not reflect an
21 industry culture where market
22 intelligence data is both equally
23 coveted and guarded. Instead, it
24 appears that today's industry
25 culture in California remains
26 marked by patterns of open
27 communication more typical of a
28 regulated industry but

19

1 inappropriate in a competitive
2 market."

3 Can you be a little more specific on what the
4 report or the analysis was referring to?

5 COMMISSIONER LYNCH: I'm going to do this from
6 memory, because I have to say I did not review our November 22nd
7 filing before I came here.

8 CHAIRMAN DUNN: Before you do that, Donna, why
9 don't we pull this one up real quickly just so it's there for
10 the audience as well. It is on the PUC's Table of Contents,
11 p4e26. It's the very last paragraph that we're referring to,
12 Donna. And third line, you'll see, there it's. It starts with,
13 "It is the CPUC's contention," if we could just highlight that
14 real quickly. This is the phrase I'm referring to. There it
15 is.

16 COMMISSIONER LYNCH: I would say, well, I'm not
17 recalling the specific intent of our attorneys who wrote that in
18 full.

19 Certainly we knew at the time that there were
20 posted on the WSCC's data sites market information that was not
21 available, for instance, to the PUC or to other governmental
22 entities.

23 And I believe that the State of Oregon obtained
24 some of that information, and thereafter, it was ordered that
25 that market information site was shut down. So, once the State
26 of Oregon obtained it, it was not made available to others.

27 CHAIRMAN DUNN: And you --

28 COMMISSIONER LYNCH: And I believe that the State
19

1 of Oregon obtained it from one of the regulated entities who
2 also had access to that information. So, that is certainly one
3 instance in which the market participants had more at their
4 finger tips than the regulators.

5 CHAIRMAN DUNN: I realize we're tapping upon

6 memories here, because that was last fall that that report or
7 analysis was issued.

8 Let's zero in on that circumstance that you're
9 just referring to. You're referring to a time that the market
10 participants had access to what's called real-time market data?

11 COMMISSIONER LYNCH: Correct.

12 CHAIRMAN DUNN: Which the market set up, in
13 theory, to prevent access to such information?

14 COMMISSIONER LYNCH: I believe that that was the
15 theory, although I wasn't here at the time that they set it up.

16 CHAIRMAN DUNN: I understand.

17 But obviously, it was of concern to the
18 regulators when they discovered that certain market participants
19 had access to real-time market data.

20 COMMISSIONER LYNCH: Correct.

21 CHAIRMAN DUNN: Which is that bidding data that
22 we've been talking about that is confidential for a six-month
23 period.

24 COMMISSIONER LYNCH: Which took us so long to
25 obtain.

26 CHAIRMAN DUNN: And it's not only confidential to
27 us, an investigation committee, it's confidential in the sense
28 that you can't have access to it unless you enter certain

19

1 confidentiality agreements. The public can't have access to it,
2 and market participants can't have access to it. That's the
3 theory?

4 COMMISSIONER LYNCH: That was the theory.

5 CHAIRMAN DUNN: And the only folks that are
6 supposed to be in possession of that data is, for example, the
7 ISO?

8 COMMISSIONER LYNCH: That was my understanding of

9 the theory.

10 CHAIRMAN DUNN: And what was discovered is that
11 there were certain participants that for a period of time had
12 access to real-time market data?

13 COMMISSIONER LYNCH: I believe so.

14 CHAIRMAN DUNN: Do you recall what the time
15 period was of the market participants having access to that
16 real-time data?

17 COMMISSIONER LYNCH: Well, the real-time data
18 access locations were shut down last fall when Oregon went
19 public with the fact that they had it, and when the PUC
20 requested it. So, I assume that they had it up until that time
21 that those access sites were shut down.

22 CHAIRMAN DUNN: And do you have any idea,
23 Commissioner, when that real-time access was set up in the first
24 place? We know it was shut down last fall, but when was it
25 initially established?

26 COMMISSIONER LYNCH: I don't know.

27 CHAIRMAN DUNN: But it was up running, we know,
28 for a period of time?

19

1 COMMISSIONER LYNCH: And certainly through this
2 summer, when the prices began to spike so radically in
3 California, and when we experienced reliability problems.

4 CHAIRMAN DUNN: You mentioned the WSCC. What is
5 that?

6 COMMISSIONER LYNCH: That's the Western States
7 Coordinating Council, which is an industry group, an informal
8 industry group which sets industry-related standards.

9 CHAIRMAN DUNN: Okay.

10 COMMISSIONER LYNCH: Now, the states participate,
11 but aren't -- certainly really, from my perspective, don't have

12 full seats at the table.

13 CHAIRMAN DUNN: Do you know how the site through
14 the WSCC, how they initially obtained that? How did they obtain
15 access to real-time market data?

16 COMMISSIONER LYNCH: I'm sorry, I just don't
17 know.

18 CHAIRMAN DUNN: It's all right. I know we're
19 tapping on an area that you're familiar with, but it's outside
20 of your detailed knowledge.

21 COMMISSIONER LYNCH: It is could have been that I
22 knew November 22nd. But I have to say, November 22nd of last
23 year feels like a decade ago.

24 CHAIRMAN DUNN: Yesterday does at some points in
25 time.

26 I want to ask a concluding question about that
27 situation, the access to real-time market data from your
28 perspective as a regulator.

19

1 That is, if we had access to bidding strategies,
2 the way that market participants bid, prior to the creation of
3 that real-time site that they had access to. We looked at
4 bidding behavior before, and then we looked at bidding behavior
5 during the time they had access to the real-time market data.

6 If there is no significant difference between the
7 bidding behaviors in each scenario, is it fair to conclude that
8 either access to real-time data has no impact on the behavior of
9 the market, thus undermining the confidentiality argument, or
10 (b), if there is a significant difference between the two -- let
11 me take a step back and stop it there for just a second.

12 If we operate on that assumption, that the
13 behavior is the same before real-time access and during
14 real-time access, it would either be undermining the

15 confidentiality, or, when the real-time access was before that
16 period of time, they must have still had access to the bid data,
17 even though the real-time site wasn't created.

18 COMMISSIONER LYNCH: I certainly think it's fair,
19 given the first set of assumptions, for you draw that
20 conclusion.

21 And then in terms of the next question, which I
22 understand to be, could there have been other opportunities for
23 sharing of data? I think absolutely. There are all sorts of,
24 you know, industry conferences and sharing of data in a variety
25 of respects.

26 CHAIRMAN DUNN: I probably did that in an awkward
27 way, but if the bidding behavior in both circumstances is the
28 same, it either undermines the argument for confidentiality, or
19

1 they had access to that information prior to the creation of the
2 real-time site.

3 But if we find that the bidding behavior changes
4 between the two, that might do just the opposite as far as those
5 two scenarios that I've just laid out.

6 Have you, the PUC, done any, or in conjunction
7 with the Attorney General, done any comparison of the bidding
8 performance before real-time access and during real-time access?

9 COMMISSIONER LYNCH: Not to my knowledge. It may
10 be that one of our analysts is thinking that way, but that's not
11 the focus.

12 CHAIRMAN DUNN: The reason I ask the question,
13 it's curious to us, if in fact there was a change -- I'm sorry,
14 if there wasn't a change as far as bidding behavior because of
15 the conclusion that either undermines the argument for
16 confidentiality, or it suggests they have that data regardless
17 of the real-time site or not.

18 COMMISSIONER LYNCH: It certainly warrants
19 further investigation.

20 CHAIRMAN DUNN: Let's go to p4-14.
21 Is it proper to say Commissioner or should it be
22 President?

23 COMMISSIONER LYNCH: You can just say Loretta.

24 CHAIRMAN DUNN: I did that at one other hearing,
25 and I got yelled at for that.

26 We've got it up. There is a sentence in there,
27 it is the third paragraph, Donna, right there. That paragraph
28 right there. Let's do the first about five lines.

20

1 Question on one, do you see what it says there,
2 Commissioner.

3 COMMISSIONER LYNCH: Yes.

4 CHAIRMAN DUNN: The question is, what additional
5 progress can you report on today with respect to the summer of
6 2000?

7 COMMISSIONER LYNCH: Well, certainly we've
8 received most of the documents, I believe, in terms of the bid
9 and run data.

10 I don't know if we've received all the other
11 ancillary categories of material we've asked for from the
12 participants.

13 But that has enabled us to do the kinds of
14 analysis, like the example I provided you, and actually more
15 than that. To look not only at individuals, but look across the
16 board on particular days.

17 CHAIRMAN DUNN: What additional activity do you
18 anticipate undertaking in the coming months to complete your
19 investigation?

20 COMMISSIONER LYNCH: Frankly, it's analyzing the

21 mountains of data, and then correlating that with additional
22 information from scheduling coordinators and other entities.

23 So, I'd say we're well underway, and we have
24 periods of time that are pretty fully analyzed.

25 And then, obviously, aside from data analysis,
26 there are all sorts of techniques that one could employ in an
27 investigation, including interviews or other kinds of, you know,
28 discussions with individuals.

20

1 CHAIRMAN DUNN: Any other anticipated actions,
2 other than analyzing the data right now? I know that could
3 change, but anything that you're anticipating? Any other
4 subpoenas, et cetera, that you're anticipating?

5 COMMISSIONER LYNCH: I believe we are continuing
6 to issue subpoenas. As we learn more from the data analysis, we
7 are digging deeper into the causes of the kinds of illustrative
8 examples I showed.

9 So, what we're looking for is all sorts of
10 behavior, both before, during, and after periods of short
11 supply.

12 But that doesn't mean that we're going to limit
13 ourselves to just periods of short supply, because as you know,
14 the price of power in California has increased in every hour of
15 every day, regardless of whether there's a Stage One, Two or
16 Three.

17 CHAIRMAN DUNN: Page 24, it says:

18 "CPUC respectfully submits a
19 generator, marketer, and
20 scheduling coordinator contract
21 transactions, import and export
22 activity with adjacent control
23 areas, and actual metered energy

24 flows at the inter-ties must be
25 thoroughly examined. "

26 With respect to the metered energy flows, has
27 that been done?

28 COMMISSIONER LYNCH: I think that's underway, and
20

1 I think broadly that describes one thing that has been commonly
2 referred to as the potential for megawatt laundering.

3 CHAIRMAN DUNN: Can you explain that?

4 COMMISSIONER LYNCH: Well, one example of
5 megawatt laundering, and I think that it has many broad
6 applications, is to have an entity that produces the power, sell
7 it to another entity, who then essentially sells it out of
8 state. And then you can sell it back into state at a particular
9 time of shortage.

10 And originally, I think, that that referred to
11 being able to sell into either the ancillary services market, or
12 the out of market calls.

13 I think under the proposed mitigation measures
14 proposed by the FERC, they could encourage megawatt laundering
15 because the mitigation measures don't apply to certain sellers,
16 and don't apply to out-of-state purchases. So, I think it gives
17 an incentive for generators to sell prior to a Stage One
18 shortage, production out-of-state, which then can be sold back
19 in during a Stage One shortage without the price mitigation
20 measures that are proposed.

21 I would like to add, you had asked what other
22 experts we have on the case. I would suggest that my colleague,
23 Carl Wood, who worked in utility plants for decades is one of
24 our experts who we're certainly tapping, because he knows on a
25 day-to-day experiential basis what goes on in certain of these
26 plants.

27 CHAIRMAN DUNN: What we're doing here is just
28 going through, in that report we've been discussing, our 20

1 analysis, the title of it is, "Serious Questions Raised by
2 These Conditions in Prior Reports."

3 One of the questions that was raised is, where is
4 the power coming from to maintain the same level of imports?

5 Do you have an answer to that question?

6 COMMISSIONER LYNCH: We have some preliminary
7 answers, but I think that, well, I would actually refer you to
8 Dr. Wolak's analysis that he submitted to the FERC, I believe in
9 response to the November 1st report, but it could have been a
10 bit thereafter, which demonstrates a rise in exports from
11 California generating facilities last year, over the year
12 before.

13 CHAIRMAN DUNN: Any other source?

14 COMMISSIONER LYNCH: You know, nothing comes to
15 mind, but I would reserve the right to supplement my answer.

16 CHAIRMAN DUNN: Like every good lawyer.

17 I think we've reached the end for you,
18 Commissioner. Any additional comments you wish to share?

19 COMMISSIONER LYNCH: Well, I would suggest that
20 the lawyers who wrote the various FERC analyses, and analysts
21 who wrote the FERC analyses, in the context of those analyses,
22 rather than in the context of our investigation, are certainly
23 available to the committee at your convenience. And they are
24 the folks who have lived and breathed both the analysis and
25 response to the FERC November 1st order, and of course the
26 investigation.

27 I'd be happy to make those folks available at
28 your convenience.

20

1 CHAIRMAN DUNN: Which is exactly why we're
2 deferring those questions today, because I suspect you'll say,
3 you've got some knowledge on those, but it's best to ask those
4 who are intimately involved with each of those analyses, et
5 cetera.

6 COMMISSIONER LYNCH: Right, and then certainly,
7 some of our FERC lawyers are back in Washington at this point,
8 arguing in hearings regarding our natural gas complaints. And
9 that certainly plays a part in the whole supply and price
10 analysis.

11 CHAIRMAN DUNN: And briefly describe for us, what
12 are those natural gas complaints filed by the PUC?

13 COMMISSIONER LYNCH: Certainly.

14 In April of 2000, the PUC voted to file a
15 compliant against El Paso for a variety of anti-competitive
16 behavior on the pipeline that comes into Southern California.

17 As I'm sure you're well aware, the price paid by
18 California for natural gas at the California border is much more
19 than the price paid by surrounding states. And there have been
20 times in the past six months where Californians paid almost
21 double or more for natural gas supplied into California than
22 other states.

23 So, we had filed at the FERC, and Southern
24 California Edison joined with us in our complaint against El
25 Paso. That complaint languished at the FERC for almost a year,
26 although we had filed for summary judgment and --

27 CHAIRMAN DUNN: Mr. Pease is smiling behind you
28 right now.

20

1 COMMISSIONER LYNCH: -- and other procedural
2 Mechanisms to bring our complaint to the FERC's attention.

3 And then, at the end of March, the FERC decided

4 to hold hearings on certain aspects of our complaint. And those
5 hearings are ongoing as we speak. Actually, this week.

6 CHAIRMAN DUNN: Senator Bowen.

7 SENATOR BOWEN: I do have one question.

8 We've had some discussion about what happened
9 last summer in San Diego, where we had enormous rate increases.
10 I just wanted to get some idea of the magnitude of what's
11 happening now.

12 If PG&E and Edison customers were currently in
13 the situation that SDG&E customers were in last summer, what
14 kind of rate increases would they be seeing?

15 COMMISSIONER LYNCH: They'd be seeing
16 substantially higher rate increases than what the PUC has
17 already imposed.

18 Certainly, the rate increase, the three-cent and
19 the one-cent per kilowatt hour rate increases that the PUC's
20 imposed in 2001 do not fully account for the real-time wholesale
21 price of power, which has ranged in the over \$250 a megawatt
22 hour on average, meaning every hour of every day since
23 December. And in some months, it's certainly spiked higher than
24 that.

25 So, that correlates to 25 to 35 cents on the spot
26 market. And even with these rate increases, customers in the
27 PG&E and Edison territory will be paying more on the range of 11
28 to 17 cents for their power, for the energy component of their
20

1 bill.

2 So, the differential is the bonds. The bonds are
3 essentially -- the Legislature voted out recently the bond
4 revenues.

5 SENATOR BOWEN: We're spreading.

6 My question really just goes to, again, the

7 magnitude. And we had testimony this morning that we've gone
8 from \$7 billion to 27, to what's expected to be as high as \$70
9 billion dollars in electricity costs this year.

10 I think the public's just trying to understand
11 whether, under any scenario, that could be the result of a
12 workably competitive market, and whether, under any
13 circumstances, those could be called just and reasonable
14 wholesale rates.

15 COMMISSIONER LYNCH: Well, certainly, a ten-fold
16 increase in the price of power, year over year, which does not
17 at all track an increase in demand. So, for instance, on any
18 given day that you can pick in 1999, the price of power was in
19 the 3 to 4 cent range per kilowatt hour.

20 On any given day in 2001, you correlate -- say,
21 April 1st to April 1st, or January 1st to January 1st -- the
22 demand is pretty similar year over year. Although, on any given
23 day you'd need to account for weather changes. But the price
24 that we're seeing now is almost ten-fold what we saw just a year
25 ago.

26 So, if that holds, if that trend holds, just as
27 in San Diego, where San Diego customers saw a 200 to 300 percent
28 increase in their rates between May, June, and July of the year
20

1 2000, I see no reason why, if we tracked through those
2 exorbitant wholesale prices, the customers wouldn't see a
3 concomitant increase in their rates across the rest of the
4 state.

5 And I agree with you, Senator Bowen, that under
6 no scenario would a ten-fold increase in the wholesale price of
7 power for the same relative levels of demand be considered just
8 and reasonable.

9 SENATOR BOWEN: What was the percentage increase

10 in the natural gas market this winter; do you know? Isn't it
11 200 percent in some instances?

12 COMMISSIONER LYNCH: Or more. I mean, there was
13 a period --

14 SENATOR BOWEN: And there are allegations of
15 market irregularities with regard to transportation of natural
16 gas as well.

17 COMMISSIONER LYNCH: Certainly the PUC has
18 alleged that against El Paso at the FERC, and we believe that
19 the evidence we provided under seal in, or in a confidential way
20 not only alleges it, but proves it.

21 But in terms of the just and reasonableness of
22 these wholesale prices, even the federal regulators, even the
23 FERC, has determined that these prices are not just and
24 reasonable for some periods. They determined that in their
25 November 1st draft order, and again in their December 15th
26 order. I believe individual statements by Commissioners have
27 determined that again and again and again.

28 So, I don't think that there's a question that
20

1 these prices are not -- are unjust and unreasonable. And
2 there's no question that the market is dysfunctional, the
3 wholesale electricity market.

4 The only question is, what are we going to do
5 about it? And that lies squarely within the jurisdiction of the
6 federal regulators.

7 SENATOR BOWEN: Is the Federal Energy Regulatory
8 Commission's obligation to ensure just and reasonable rates
9 conditioned in any way on a market structure that does or
10 doesn't do certain things, or is it an absolute statutory
11 requirement?

12 COMMISSIONER LYNCH: The statute is a mandate to

13 ensure just and reasonable prices for the wholesale price of
14 electricity or energy on the wholesale market.

15 Just as the California Public Utilities
16 Commission is under a mandate to ensure just and reasonable
17 retail prices.

18 SENATOR BOWEN: Thank you.

19 CHAIRMAN DUNN: One follow up, then Evelyn, we're
20 about to give you another break.

21 You mentioned in response to Senator Bowen's
22 questions that, in fact, we can't accept, I mean California,
23 from the perspective of California, that ten-fold increase.
24 Clearly, that's going to do severe economic damage, and we're a
25 little over six months away to determine whether this year sees
26 a \$70 billion charge.

27 From your vantage point, Commissioner, do you see
28 anything right now that's going to impact the wholesale market
20

1 in the next six months to prevent us from reaching that
2 unfortunate goal of \$70 billion?

3 COMMISSIONER LYNCH: Only if Californians pull
4 together to conserve like we've never conserved before. We can
5 shave that number, but we can't avoid the exorbitant ten-fold
6 increase unless the federal regulators take the next step, after
7 they've found that the market is dysfunctional, and the prices
8 are just and unreasonable. Now they need to fashion a remedy
9 that works for that unjust and unreasonable price.

10 So, I hope all Californians, business, and
11 families, and farms alike, will do everything possible to
12 conserve energy, because clearly, that last megawatt that we buy
13 is often the most expensive megawatt on the range of extravagant
14 to exorbitant to outrageous.

15 CHAIRMAN DUNN: Anything that gives you

16 confidence today, as you sit here, that FERC is going to act in
17 a way to prevent that \$70 billion price tag from being reached
18 here in California?

19 COMMISSIONER LYNCH: If hindsight is any judge,
20 there have been no actions that have been helpful to California,
21 and there've been many actions that have been detrimental in the
22 last year, or certainly in the last three years.

23 I would hope that the federal regulators, when
24 they're assessing whether or not there's market power in the
25 market, when they're assessing whether or not the sellers are
26 entitled to continue market-based rates, would keep well in mind
27 their prior conclusions, that these rates are unjust and
28 unreasonable.

21

1 CHAIRMAN DUNN: In other words, at least given
2 what evidence we have thus far, not a lot of faith in the coming
3 six months about what FERC may or may not do?

4 COMMISSIONER LYNCH: I only hesitate because the
5 composition of FERC is changing. And I certainly have hope that
6 the new Commissioners who are in my position -- they are heads
7 of various state commissions -- will understand better a state's
8 experience.

9 But I don't believe we can count on the FERC to
10 enforce the Federal Power Act's mandates. In the State of
11 California, Californians need to pull together to use as little
12 energy as possible this summer, because all the energy, aside
13 from the utility-retained generation that's going to be
14 produced, is going to be produced at exorbitant prices.

15 CHAIRMAN DUNN: Commissioner Lynch, thank you
16 very, very much for your time this afternoon, for you input
17 regarding the investigation that is underway at the PUC.

18 As we said from the very get-go of this

19 investigation, we want on build on top of what is already out
20 there, and not necessarily duplicate. And we appreciate your
21 time and testimony today.

22 We're going to take a couple minute break, and
23 Mr. Pease, we're going to bring you back, and we're going to
24 finish you up, if that's okay with you, Mr. Pease. You're
25 hanging in there, okay.

26 Thank you, Commissioner.

27 COMMISSIONER LYNCH: Thank you.

28 [Thereupon a brief recess

21

1 was taken.]

2 CHAIRMAN DUNN: Why don't we get started. We're,
3 of course, at a late hour. We never anticipated reaching 5:00
4 clock, but again we did it. We'll try to wrap up very, very
5 quickly.

6 Let me just go back to Senator Bowen, who we so
7 rudely interrupted when we took the break before the
8 Commissioner.

9 I do want to again extend our sincere gratitude,
10 Mr. Pease, because I know it's been a long day, and you've taken
11 several interruptions. You probably could have been on a plane
12 home by now. We truly, truly appreciate your indulgence in
13 remaining here at this late hour as well.

14 Senator Bowen, I do have a few questions I can
15 ask, if you would like.

16 Going back to just kind of touching upon several
17 different issues that we talked about before, cost-based data.
18 I'm getting different messages, not from you, Mr. Pease, but
19 from other sources, that that information is only available via
20 FERC.

21 Is that true not true? I mean, it may be

22 protected under confidentiality, but it's only FERC that has
23 that data.

24 MR. PEASE: I don't know what data the ISO has on
25 the actual costs to the generators. I know that they -- I don't
26 know that answer.

27 I know that we have asked, and are continuing to
28 ask, for a lot of that data as part of ongoing investigations.

21

1 As I indicated earlier in my prepared testimony, we are
2 conducting investigations and trying to determine the actual
3 ratings of these generators.

4 For example, in the ISO reports on their web
5 site -- and I'll refer to those reports since they're public
6 rather than any confidential information they've turned over to
7 us -- there is a difference in a number of generators that they
8 list as the rating capacity of a particular generator, and they
9 list that certain amount as an outage every day.

10 We're trying to clarify those issues. We're
11 trying to look and are going to look as part of the April order
12 at the actual costs these generators are incurring. And our
13 formula, which is set out, I referred to earlier, taking into
14 account the costs of the generators for the fuel, as well as
15 their heat rate, as well as the costs, environmental costs, of
16 their emissions are all going to be included. We're gathering
17 lots of data on that, on those particular costs of each
18 generator that's operating in California grid.

19 CHAIRMAN DUNN: And the importance of that
20 information to FERC is that it would be a factor in your just an
21 reasonable assessment as to the prices being charged on the
22 wholesale electricity market?

23 MR. PEASE: That's true. Everything is under the
24 just an reasonable standard here. But what specifically we're

25 looking for there is to determine the proxy price for -- to
 26 determine when the costs are going to be included in the market,
 27 and those that are going to be beyond influencing the market
 28 price. So that we wouldn't have instances, in terms of Senator
 21

1 Bowen's question earlier, and evidence that President Lynch
 2 referred to, of where you have extreme spikes, and those spikes
 3 are influencing the market price. Instead, those spikes would
 4 be outside of the market price, at least during the mitigation
 5 period of the Stage One period that the Commission has
 6 articulated in that order.

7 As I said, they may still get their bid, but it
 8 would not -- but they would have to justify it with filings with
 9 the Commission. But they would not influence the market price.

10 That's a dramatic change in how the market is
 11 operating. We hope that that is something that will provide
 12 concrete relief for California retail customers.

13 CHAIRMAN DUNN: Following up on some questions
 14 before, is it the ISO that has access to generator-specific
 15 information, or does FERC have access under normal conditions to
 16 that information as well?

17 MR. PEASE: Both the ISO and FERC.

18 Could I add one comment also to what we were just
 19 talking about --

20 CHAIRMAN DUNN: Please.

21 MR. PEASE: -- in price mitigation.

22 Another thing the Commission has done in terms of
 23 coming up with a marginal cost or proxy price here, which is
 24 also a big change from way the markets have been operating, is,
 25 we are not including any scarcity rents in there or opportunity
 26 costs. And those are things that the generators in many
 27 instances have argued in terms of opportunity costs,

28 opportunity -- for example, if you view some of those charts 21

1 that President Lynch put on the board there, let's assume they
2 weren't quite as dramatic as she showed. And we have uncovered
3 evidence similar to that in our ongoing investigations.

4 When you look at that, and let's take one that
5 would not have that severe of a jump. You would also have
6 situations there where the generators argue that where the
7 emergency situation or other situations of scarcity are
8 occurring, that's an opportunity for generators. That's the way
9 it is often articulated, and that justifies a higher price.

10 And we have said in the April 26th order that
11 that rationale is not a valid rationale in terms of shortage
12 situations.

13 And we hope again those scarcity rents and
14 opportunity costs, by excluding them from determining what the
15 proper cost would be that will determine the market clearing
16 price, and by market clearing price, we're talking about then
17 that price of the most expensive generator, which is then going
18 to determine the price that all are paid on the market. That
19 those prices, the marginal cost will not include those
20 opportunity situations.

21 I think that will also have a dramatic effect on
22 lowering the prices which -- on the wholesale level -- which
23 then, hopefully, will lower, or should lower the prices that the
24 retail customers are being faced with.

25 CHAIRMAN DUNN: Senator Bowen.

26 SENATOR BOWEN: Thank you.

27 Let me go back first to the Commission's most
28 recent order, because you may remember, I paused when we were 21

1 talking about the impact, the effect of that order on marketers

2 an traders. I want to go back to that, having had an
3 opportunity to review the order.

4 The order refers to generators with PGAs,
5 participating generator agreements. It's my understanding that
6 many of the marketers and traders do not have PGAs.

7 MR. PEASE: That's correct, but the order is not
8 limited to those.

9 The Commission, as I read from the order in one
10 of my earlier rounds, the Commission is requiring the sellers
11 with the PGA, as well as nonpublic utility generators that make
12 sales through the ISO markets, then it also says, "or those that
13 use the ISO's interstate transmission grid."

14 SENATOR BOWEN: Right, but that doesn't solve our
15 problem either. Let's say, for example, that Joe's Generating
16 has an agreement with Bill's Marketing. And that Bill's
17 Marketing is strictly a marketing and trading organization and
18 does not use the grid ever. Only resells to someone else, a
19 classic middle man.

20 Then all of Bill's Marketing sales are outside of
21 the purview of this agreement, because they don't use the
22 transmission system. They simply resell to somebody else who
23 does, and all of those transactions by the middle men, the
24 marketers and traders, serve to drive up the price, even though
25 ultimately they don't deliver any power themselves.

26 MR. PEASE: I think the intention there is to
27 look at the entire transactions.

28 SENATOR BOWEN: Certainly that's not what the

21

1 order says. "The Commission agrees that all generators need to
2 participate to helping solve the problems in California," not
3 just generators signing PGAs. It affects all sellers that own
4 or control generators located in California.

5 MR. PEASE: Correct. That's where it's expanded
6 to, also owner-controlled generators located in California.

7 SENATOR BOWEN: But a marketer does not own or
8 control generators located in California. They just buy and
9 sell from a generator located in California. So, they don't
10 fall within this definition.

11 MR. PEASE: I'm not sure what else I can say on
12 that, Senator. My understanding is that in situations where the
13 -- I'm going to have to -- I'd also like to reserve and
14 supplement that answer to you.

15 The order is just so new, we've been trying to
16 sort out all of the things on this.

17 SENATOR BOWEN: Then the next provision of it
18 does talk about, "As a condition of using the ISO's open access
19 tariff," but then it again refers to all sellers of energy that
20 own or control generators in California.

21 But the marketers and traders, many of them,
22 Williams is an exception because it does control generation
23 located in California, but we have many marketers and traders
24 who neither use the ISO's tariff, nor owner-controlled
25 generation in California. It's Page Ten.

26 I raise this because the opportunity for avoiding
27 the order, obviously, is extraordinary if, in fact, I'm correct
28 that there's a loophole for marketers and traders who don't own
21

1 or control generation in California. Because all you would have
2 to do then to avoid being under the purview of this order is
3 simply sell your output to a marketing or trading firm that then
4 resells to somebody else, and you've got a nice chain.

5 MR. PEASE: If they have -- the obligation that
6 is addressed in that particular provision is where the capacity
7 is not specifically -- where the capacity is available and not

8 already scheduled to run through with bilateral agreement. So,
9 if a generator has an agreement, a bilateral agreement with
10 another customer, be it a marketer or not, that power would then
11 not be available, and it would have already been sold.

12 And the intent here is going --

13 SENATOR BOWEN: It's already sold, but it can
14 come back into the state at any price; right? Or it can be
15 resold to either DWR, or if we get the utilities back into
16 business, to a utility at any price?

17 MR. PEASE: I can't say that this provision
18 completely eliminates what President Lynch was referring to as
19 megawatt laundering, and selling it and going out of the
20 state --

21 SENATOR BOWEN: I'm not even concerned about
22 going out of the state. I don't even think it affects going out
23 of the state.

24 I just think if you sell to a marketing or
25 trading company, and you're then not a seller that owns or
26 controls a generator, you're not subject to this. Whoever that
27 middle person is can then sell back and has no responsibility
28 under this provision for complying with the order. They're just
21

1 outside of the language.

2 This is a particular problem this summer because
3 we know so much of the generation was sold, the output from
4 facilities in California has already been sold. The DWR
5 attempted to contract for much of that power. It was unable to
6 do so. So, we know whoever the marketers who are traders,
7 presumably that's who holds the rights to that right now, has no
8 obligation to sell it in compliance with this mitigation order.

9 MR. PEASE: Certainly that is not the intention
10 of the order. As I said, I will have to reserve my further

11 comment, and I want to make sure that I'm accurate before I
12 respond to that.

13 But I don't think the hole is as large as you may
14 believe, but I will get back to you on that, Senator.

15 CHAIRMAN DUNN: Can I interrupt with one quick
16 question.

17 And if in getting back to us, Mr. Pease, you find
18 that the hole is that big, can it be fixed?

19 MR. PEASE: I certainly would hope so.

20 CHAIRMAN DUNN: And how would one go about doing
21 that?

22 MR. PEASE: I'd rather not speculate on that, but
23 there should be ways that we can tighten this up. But I'd
24 rather wait before I would speculate on what the Commission
25 would do there.

26 SENATOR BOWEN: We seem to have a fair amount of
27 conflict between FERC's look at forced outages and the PUC's
28 look at forced outages.

21

1 So, my question really is just -- and much has
2 been made about the fact that these plants are 30 years old,
3 some of them. Granting the plant operators the benefit of the
4 doubt, we'll say that they're 30 to 40 years old this year.

5 But the outage, the forced outages seem to be
6 three to four times what they were in 1999, when the same plants
7 were 29 to 39 years old.

8 Is it a hallmark of a workably competitive market
9 that you get in one year a tripling or a quadrupling of the
10 number of forced outages? Or would that give you cause for
11 concern?

12 MR. PEASE: Before I answer that question, I'd
13 like you to articulate where you believe there are differences

14 between the CPUC and FERC in terms of forced outages.

15 SENATOR BOWEN: The FERC's review, and I think
16 it's in the book --

17 MR. PEASE: I just want to understand where
18 you're referring to so I can accurately answer.

19 SENATOR BOWEN: FERC conducted a study of
20 outages, "Report on Plant Outages." And the study was certainly
21 at least touted by the independent energy producers as
22 demonstrating that there was nothing unusual that occurred.

23 Maybe that's an accurate characterization of the
24 report.

25 MR. PEASE: Which study are you referring to?

26 SENATOR BOWEN: This is the February 1st report
27 of the Office of General Counsel, Market Oversight and
28 Enforcement Report on "Plant Outages in the State of

22

1 California."

2 MR. PEASE: What we found there, as Senator Dunn,
3 I think, was referring to earlier comments, the difficulty of
4 proving a forced outage is not legitimate.

5 These are old plants, and things go wrong at old
6 plants. It's very difficult, which is why we have stepped up
7 our monitoring of these plants, and as I indicated earlier,
8 including site visits and audits of these plants to try to
9 determine whether these outages are legitimate or not.

10 And it is very difficult, as President Lynch
11 testified. And the thrust of Senator Dunn's question to her,
12 which I think came from Professor Wolak's comments about sick
13 days, it is very difficult to establish that they're actually
14 sick.

15 But I'm not sure there is a disagreement between
16 the CPUC's view of these outages and our view of these outages.

17 It's the difficulty in proving that the forced outage was
18 evidence of market manipulation.

19 SENATOR BOWEN: But to you, does the fact that
20 there are three to four times many outages currently as there
21 were in the prior year have any bearing on that question?

22 MR. PEASE: It raises significant questions in my
23 mind that there may be things going on here that were not going
24 on in the past, which is why we are conducting extensive
25 investigations into the behavior of the generators, an in
26 particular, their forced outages.

27 We're looking at historical data over long
28 periods of time on the particular plants to see what is going on
22

1 there.

2 I share the concern that's expressed in your
3 concern, and I assure you that that is something we are
4 specifically looking into.

5 SENATOR BOWEN: I don't want to discount the age
6 and hard running.

7 MR. PEASE: Those are legitimate issues.

8 SENATOR BOWEN: It is. I certainly know that
9 after I reached a certain age, I had more forced outages.

10 MR. PEASE: There is -- there are a few
11 significant differences in terms of these plants.

12 While there's been testimony today that the
13 overall demand may not have increased that much, although
14 there's certainly dispute as to what the overall demand has
15 been, and how much it has increased, the numbers are out there.

16 But it's coming from different supplies than it
17 did in the past. And one of those -- the generators are running
18 harder, and I think there's pretty much universal agreement of
19 that because of the reduction of hydro power. And there's been

20 a significant reduction in the amount of hydro power that's
21 coming in --

22 SENATOR BOWEN: Not last summer; right? Last
23 summer we didn't have any reduction in the amount of hydro
24 power.

25 MR. PEASE: My understanding, there was a
26 reduction last summer, but certainly there is a reduction now.
27 That has been a factor, not the factor, but it's also a factor
28 to consider in terms of these generators are running more.

22

1 We have come across some evidence that the
2 generators, as you said, are older. They do break down more,
3 but they are running more than they have in the past, even
4 though the overall demand in California may not have increased.
5 And that has led to some of these plants breaking down.

6 You also had the issues in terms of these plants,
7 and I certainly don't want this to sound as an apology. We
8 share your concern here and are investigating it, as I said.

9 But you have situations where there was a
10 transference of these plants from being owned by the investor-
11 owned utilities to the generators. There was significant
12 uncertainty at the end of the period that the utilities own
13 them, as to what was going to happen to these plants. And there
14 was significant uncertainty in terms of the generators that were
15 taking them over, how they were going to be run, what the market
16 returns were going to be, et cetera.

17 And we are looking for this historical data
18 during that period and earlier to compare essentially three
19 periods.

20 Before, when the IOUs operated them, how did they
21 run them? What happened? How did they break down? How did
22 they maintain them?

26 classification demanded, observed,
27 charged, or collected is unjust,
28 unreasonable, unduly discriminatory, 22

1 or preferential, the Commission
2 shall determine the just and
3 reasonable rate charge
4 classification, a rule, regulation,
5 practice, or contract to be
6 thereafter observed and in force,
7 and shall fix the same by order. "

8 Doesn't this place an obligation on the
9 Commission to deal with unjust and unreasonable rates at all
10 times, not just during Stage One, Two or Three emergencies?

11 MR. PEASE: Yes.

12 SENATOR BOWEN: Then why does the order only
13 address Stage One, Two and Three emergencies?

14 MR. PEASE: In the order, the Commission -- as I
15 said, the Commission's position has changed somewhat.

16 But the Commission found that -- the Commission
17 articulated a rationale that it was going to develop this proxy
18 price or marginal cost price for Stage One because it believed
19 that was the period that generators had the most opportunity to
20 influence the market. In other words, when there were
21 shortages.

22 That does not mean that the Commission does not
23 have an obligation at all times to determine that it is just and
24 reasonable. The Commission has to make those findings and go
25 from there.

26 SENATOR BOWEN: So, if rates are unjust and
27 unreasonable at 2:00 o'clock in the morning, and there's no
28 power shortage, the Commission still has an obligation under the

1 Federal Power Act to fix a just and reasonable rate for that
2 time?

3 MR. PEASE: At all times. I mean, there is no
4 limitation on them. That's what the Commission has prescribed
5 as a remedy, the marginal cost so far, and then other orders on
6 refunds that we talked about earlier. That's what the
7 Commission has articulated as a remedy as to what it is going to
8 do, at least so far, as a result of finding that the market
9 prices were unjust and unreasonable.

10 The first step is finding the unjust,
11 unreasonable. I know I made this as clear as mud. But the
12 first step is the finding that it's unjust and unreasonable.
13 The next step is, what is the Commission going to do about it?

14 So far, that's what the Commission has
15 articulated what it feels is appropriate to do about it.

16 SENATOR BOWEN: Does the Commission have the
17 legal authority under Section 206 to continue a tariff that does
18 not result in just or reasonable rates?

19 MR. PEASE: I don't believe so. I think if the
20 Commission makes a finding that something, that a rate is unjust
21 and unreasonable, and that tariff is implemented to fulfill the
22 prior rate that was unjust and unreasonable, I think they go
23 hand-in-hand.

24 SENATOR BOWEN: Does that imply a finding then on
25 the Commission's part that the rates during nonstaged periods,
26 or at 2:00 o'clock in the morning, are just and reasonable at
27 current levels?

28 MR. PEASE: No. As I said before, what the

1 Commission found in the December Order was that the rates were
2 unjust and unreasonable.

3 Then the Commission must say, well as a result of
4 them being overall unjust and unreasonable, when in particular
5 should the Commission order refunds to correct the unjust and
6 unreasonable rates?

7 SENATOR BOWEN: But I'm not talking about refunds
8 right now.

9 I'm talking about the rate, charge,
10 classification, rule, regulation, practice, or contract "to be
11 thereafter observed and in force," which seems to me to
12 absolutely require the Commission to adopt orders that ensure
13 just and reasonable rates at all times.

14 I don't understand how the current order complies
15 with Section 206 of the Federal Power Act.

16 MR. PEASE: I understand that you disagree with
17 what the Commission has said as a result of unjust and
18 unreasonable, the finding of unjust and unreasonable rates.

19 SENATOR BOWEN: I'm just asking about the legal
20 duty.

21 I asked you if there's a legal duty to ensure
22 just and reasonable rates at all times, and --

23 MR. PEASE: Yes. The answer to that is yes.

24 SENATOR BOWEN: So then, what's the legal
25 authority for an order that only addresses some periods when
26 unjust and unreasonable rates have been found to exist?

27 MR. PEASE: I'm not sure I can speculate beyond
28 what the Commission has said specifically in its orders.

22

1 SENATOR BOWEN: Okay.

2 CHAIRMAN DUNN: I have a few questions, and we're
3 probably nearing the end. That was more for Evelyn's benefit, to
4 be honest with you, Mr. Pease.

5 You mentioned in response to Senator Bowen's

6 question before that there's a number of issues obviously that
7 FERC is continuing to look into with respect to the behavior of
8 the market participants on the California wholesale electricity
9 market, and that's an ongoing process; correct?

10 MR. PEASE: That's correct.

11 CHAIRMAN DUNN: Is one of the aspects that you
12 are currently looking into is the possibility of coordinated or
13 collusive activity between two or more market participants?

14 MR. PEASE: I think I testified earlier that we
15 are specifically looking at any evidence of collusion, collusive
16 behavior.

17 CHAIRMAN DUNN: For the investigations that
18 you're doing, I understand you're covered by a lot of
19 confidentiality provisions. We've talked about them
20 extensively.

21 Can you share with us what requests have been
22 made? What subpoenas have been issued going at the heart of the
23 coordinated activity issue?

24 MR. PEASE: I think that's a question you've
25 asked in a couple of different ways earlier.

26 CHAIRMAN DUNN: Leave it to the lawyer to try.
27 All of us up here, us lawyers, plural.

28 MR. PEASE: I understand your frustration. But
22

1 if I told you what we are asking about, and who we are asking
2 questions of, that would certainly breach the confidentiality
3 requirements that I'm under.

4 CHAIRMAN DUNN: All right.

5 Is it fair to describe, you've got one large
6 investigation underway, or is it broken up into a multitude of
7 investigations?

8 I know you've identified a variety of areas that

9 you're looking into.

10 MR. PEASE: You could characterize it either way.
11 We're certainly coordinating all of our activities throughout
12 the Commission, and all the different offices are working
13 together on the various investigations. It's not merely the
14 Market Oversight Section and Enforcement. As I referred
15 earlier, the Energy Market Section and other sections throughout
16 the Commission.

17 So certainly, we are coordinating. If you want
18 to call it one California investigation, if you want to call it
19 15 California investigations, I'm not sure it matters.

20 CHAIRMAN DUNN: Understood.

21 Just out of curiosity, how large is the Federal
22 Energy Regulatory Commission?

23 MR. PEASE: We have 1200 employees, with about
24 1,000 in the Washington office. We have five regional offices
25 spread throughout the country. Those regional offices deal
26 exclusively, or virtually exclusively, with hydro power. And we
27 have an office in San Francisco, Chicago, Atlanta, and New York,
28 and Portland.

22

1 CHAIRMAN DUNN: So the investigation into the
2 California wholesale electricity market is at least primarily
3 driven out of Washington.

4 MR. PEASE: Exclusively out of Washington, along
5 with consultants, as President Lynch testified to and others.
6 Certainly, because this is an area that is requiring a high
7 degree of expertise, there are times that we also employ outside
8 consultants to give us advice.

9 But the investigations are being run out of
10 Washington.

11 CHAIRMAN DUNN: And is it publicly available

12 information as to who those consultants are that FERC has
13 retained with respect to its investigation of the California
14 wholesale electricity market?

15 MR. PEASE: Not at this time, other than, I think
16 we referred to in one public report where we coordinated with
17 the ISO and used Black and Beech.

18 MR. PEASE: Are there any anticipated new reports
19 that FERC will be issuing in the next, say, three months with
20 respect to the California wholesale electricity market?

21 MR. PEASE: I guess the best way to answer that
22 is, the Commission has not announced any date by which it was
23 going to release any specific reports.

24 Certainly there are, as you can imagine, ongoing
25 reports internally as to the results of what we are finding as
26 we go along.

27 I'll stop there.

28 CHAIRMAN DUNN: I want to distinguish between 23

1 reports or information published in response to FERC filings,
2 and so forth.

3 But like Commissioner Lynch had done, she
4 actually issued a report, although in conjunction with another
5 individual, Mr. Kahn.

6 Does FERC anticipate issuing a general report
7 examining the California wholesale electricity market?

8 MR. PEASE: Well, we have issued reports in the
9 past, as you know. Senator Bowen referred to one of them.
10 We've issued a report in November on the markets in the west and
11 throughout the entire country as well, but particular emphasis
12 on California.

13 And I think the Commission indicated that there
14 may be periodic reports of a similar nature with concentration

15 on California in the future, but it didn't specify any
16 particular dates by which it was requiring staff to issue any
17 reports.

18 CHAIRMAN DUNN: Do you recall when the State
19 Auditor was here earlier, a long time ago, seemingly now, we put
20 up on the screen a publication that's been distributed by the
21 Independent Energy Producers Organization that lists 11
22 investigations that they are holding out to have given them a
23 clean bill of health.

24 Do you remember that one?

25 MR. PEASE: I certainly do.

26 CHAIRMAN DUNN: Lucky FERC, you're on the list.

27 MR. PEASE: We were indeed.

28 CHAIRMAN DUNN: Is it a fair characterization 23

1 that FERC has at any time, implied or directly, issued a clean
2 bill of health governing the generators and their behavior on
3 the California wholesale electricity market?

4 MR. PEASE: No, it certainly hasn't.

5 CHAIRMAN DUNN: All right.

6 I would imagine in the course of your work,
7 Mr. Pease, that FERC has examined the work products, the
8 reports, that have been issued by California ISO's Market
9 Surveillance Committee, Market Analysis Committee, plus the same
10 from the California PX; true?

11 MR. PEASE: Of course.

12 CHAIRMAN DUNN: In reviewing those reports, does
13 FERC have any criticism of either the methodology or the
14 conclusions reached in those reports?

15 MR. PEASE: Are you asking me or are you asking
16 FERC?

17 CHAIRMAN DUNN: Let's start with you first,

18 Mr. Pease.

19 MR. PEASE: I guess I probably poorly worded
20 that, because I don't think I'm going to speculate beyond what
21 FERC has said on those orders.

22 We have not really -- "we" being the
23 Commission -- have not -- I don't recall any specific statements
24 we've made in orders or elsewhere on any of the particular
25 reports, except we've referred to them in various orders, and
26 we've agreed with portions of them in various orders. I can't
27 cite to you off the top of my head the various references, but
28 certainly there have been a number of references in the orders
23

1 to studies by the ISO, and numerous studies that we've all
2 discussed here today. Probably every one that we discussed
3 today has been referenced at some point in a Commission order,
4 and generally favorably.

5 CHAIRMAN DUNN: So to the best of your knowledge,
6 FERC's never issued any criticism of the methodology or
7 conclusions contained in those reports that I identified?

8 MR. PEASE: Now, FERC has asked a significant
9 number of questions of the ISO. One of its more recent studies,
10 where it made the allegations of over \$6 billion of improper
11 charges. The Commission had quite a few questions on that, and
12 I think the ISO significantly altered its original statements in
13 response to the questions that came from FERC. Six billion
14 dollars went down to \$1.3 billion, as I understand it.

15 So, yes, we had quite a few questions about the
16 methodology used in that particular study, and that's a matter
17 of public record.

18 But in terms of other ones, I don't think we
19 articulated questions to the extent that we did on the most --
20 more recent study. I don't know if it's the most recent study,

21 but Sheffrin's study, that originally listed six-point-something
22 billion dollars. We had quite a few questions, and articulated
23 those in public data requests that went out to the ISO.

24 CHAIRMAN DUNN: We're probably going to have a
25 disagreement on this, Mr. Pease, and you stated that "we" FERC
26 had a number of questions following that report. And as you
27 just stated, from your perspective, it went from six-some-odd
28 billion down 1.3.

23

1 Wouldn't it be a fair characterization of the
2 same thing that those questions asked, well, if you narrowed
3 your analysis to certain time periods and certain categories,
4 wouldn't that figure come down, as opposed to an outright
5 criticism of what work had been done in that report?

6 MR. PEASE: I don't think FERC was trying to
7 criticize what was done in that report, and I certainly don't
8 want to give that implication.

9 One of the biggest questions that FERC had was
10 very similar to what you just said, narrowing periods of time.
11 But there the periods of time, significant dollar amounts in the
12 ISO study was for the period prior to October. And that's the
13 refund date that the Commission articulated.

14 So, that had a big impact. I mean, if you're
15 going to include periods before the Commission had found that
16 the rates were not just and reasonable, the Commission didn't
17 feel that it could, on a generic basis, order refunds for that
18 period. There was a fundamental difference there.

19 It wasn't a criticism of the methodology, per se,
20 that they used, and how they determined whatever dollars were
21 from that period. But instead was, that period was outside of
22 the scope of what the Commission was looking at in terms of
23 potential refunds. I think that was a legitimate question.

24 CHAIRMAN DUNN: That's exactly where I was coming
 25 from, because at least I interpreted your initial comments re
 26 that last report as suggesting that FERC may have disagreed with
 27 either the methodology or the conclusions. But in fact, those
 28 questions were simply saying, from FERC's perspective, "We only
 23

1 want to look at this time period. Your report covered a broader
 2 time period. Please limit it to our time period." And that
 3 brought the figure down substantially.

4 MR. PEASE: I think that is where most of the
 5 questions went to. There may have other questions. We were
 6 seeking understanding, a further understanding of the
 7 methodology.

8 I don't think the Commission has commented on
 9 whether it agrees or disagrees with the methodology with respect
 10 to the issues that it raised in some of those data requests.

11 But I certainly don't want to give the impression
 12 that the Commission is criticizing that report. We needed a
 13 better understanding of it, because we certainly want to take
 14 that report and other reports that are coming from the ISO into
 15 consideration when we make our -- when the Commission makes its
 16 deliberations and makes its findings.

17 We rely significantly on the ISO, although far
 18 from exclusively, as we discussed, with all the investigations
 19 we have ongoing. But we rely on them to provide data for us.
 20 They are closer to the market than we are. They are experts in
 21 the California market. They see the behavior.

22 That is why, in the April 26th report, the
 23 Commission articulated that it wants even better coordination
 24 between the ISO and FERC, and it wants the ISO -- it gave an
 25 affirmative obligation on the ISO to report anomalies to us.
 26 Prior to that, it was unclear if you could say there was an

27 obligation on them to report it us. Certainly, they exchanged
28 quite a bit of information. And as you know, the AES Williams
23

1 initial referral came from the ISO. So, there's always that
2 exchange.

3 But here, we wanted to make sure there is no
4 ambiguity. If you find things, tell us; tell us right away.

5 CHAIRMAN DUNN: Mr. Pease, have you had any
6 direct dealings or familiar with let's just take the three most
7 obvious examples from those market surveillance folks here in
8 California, Frank Wolak, Eric Hildebrandt, Anjali Sheffrin? Do
9 you know those individuals personally?

10 MR. PEASE: Yes.

11 CHAIRMAN DUNN: And you've had an opportunity
12 over the years to work with them?

13 MR. PEASE: Yes, either I or the people on my
14 staff have worked with all three of them, and continue to work
15 with -- well, at least with Eric and Anjali on a very regular
16 basis. I don't know if it's daily, but certainly we talk to
17 Eric quite frequently.

18 CHAIRMAN DUNN: I'm going to ask what's a pretty
19 obvious question, but I need to ask it anyways.

20 Given that working relationship that you have
21 with those individuals, you certainly haven't found any reason
22 to question their professionalism, their experience, their work
23 methods, their integrity, or their motivation for the work that
24 they do?

25 MR. PEASE: No.

26 CHAIRMAN DUNN: All right.

27 Senator Bowen, any questions? I've just got a
28 couple more.

1 SENATOR BOWEN: One of the things -- there's
2 always one last question.

3 MR. PEASE: Always.

4 SENATOR BOWEN: I know you've alluded several
5 times to the massive amounts of data that have to be evaluated
6 in order to make these determinations. Commissioner Lynch has
7 said the same, and I think there's little disagreement that the
8 challenge is great.

9 Is the Federal Energy Regulatory Commission
10 looking at ways that it might better monitor the market, to your
11 knowledge?

12 MR. PEASE: Of course. Always looking for ways
13 to better monitor the market.

14 SENATOR BOWEN: Is there any kind of formal look?

15 MR. PEASE: The Commission has not announced an
16 investigation on how to do that. But that's certainly -- I
17 personally, speaking as myself, as the managing attorney of our
18 section, that is an obligation on our section, to make sure that
19 we are monitoring as best as we can, and to change how we're
20 monitoring where appropriate, if that's the thrust of your
21 question.

22 But the Commission has not issued any formal
23 investigations to do that.

24 SENATOR BOWEN: Again, I think it's in part a
25 question about time, because as you mentioned, some of the
26 investigations from 2000 are still not yet completed.

27 And in order to have a wholesale-retail market
28 scheme that works, we can't have people waiting a year to get

1 refunds back if there have been unjust and unreasonable charges.

2 I think you probably concur that the shorter time
3 period for enforcement's better than a longer one.

4 MR. PEASE: I think I would agree with that.

5 CHAIRMAN DUNN: Does FERC have possession of the
6 energy output information for each of the California generators
7 from '90 to '98, when they were owned by the California IOUs?

8 MR. PEASE: I don't know if we have all of that
9 data. Certainly we have some of that data. We may well have it
10 all. I don't know.

11 CHAIRMAN DUNN: Assuming that FERC has the data,
12 that would be outside the six-month period and should be
13 publicly available; correct?

14 MR. PEASE: I don't think that the information
15 related to the generators before the ISO existed would have been
16 covered by that tariff provision that we have discussed at
17 length today.

18 CHAIRMAN DUNN: So, whether that six month was
19 there or not, that information I've just identified should be
20 publicly available?

21 MR. PEASE: I don't know if it's publicly
22 available or not. I don't -- off the top of my head, I
23 cannot -- I'm not sure why that information would remain
24 confidential, particularly if the ISOs no longer own those
25 facilities, and you're dealing with information that they
26 possess, not the new owners or the generators, perhaps.

27 But I don't think I want to speculate beyond
28 that, but my initial impression would be -- my initial answer
23

1 is, it's not covered by the tariff provision we have discussed
2 today.

3 If there are other reasons to keep it
4 confidential, those would again be what we discussed earlier,
5 the basic law principals that would govern confidentiality, but
6 not that tariff.

7 CHAIRMAN DUNN: All right.

8 You've been watching, I'm sure, Mr. Pease, and
9 FERC has certainly, the California wholesale electricity market
10 for sometime now. I know there's been a lot of issues raised
11 over the past couple of years about that market, and what's
12 going on or not going on in that particular market.

13 Would you agree that a fair conclusion, at the
14 very least, from all of that, is that we do not have a
15 substantially competitive market in the California wholesale
16 electricity market? Is that a fair conclusion from everything
17 that's been done?

18 MR. PEASE: I think the Commission has
19 specifically made that finding in a number of orders.

20 CHAIRMAN DUNN: Just out of curiosity, given the
21 fact that we all agree that there's not a substantially
22 competitive market in that wholesale electricity market, doesn't
23 that undercut the entire premise for allowing generators access
24 to market-based rates?

25 MR. PEASE: That's a legitimate question, and
26 it's a question that is directly before the Commission right
27 now. There have been requests in complaints and in other
28 filings to return to cost-based rates.

23

1 The current Commission has articulated on many
2 occasions that it wants to find solutions that are
3 market-driven. And that it believes that the market can, at
4 some point, work.

5 But the Commission has stated that it's not
6 working right now. I can't speculate on where the Commission is
7 going to go in that direction.

8 Certainly, the Commission's position has evolved
9 over some time. As the crisis in California got greater and

10 greater, so did everyone's attention being devoted to it.

11 CHAIRMAN DUNN: Now, several of the market-based
12 rate authority applications are up for renewal in the coming
13 months; correct?

14 MR. PEASE: That's my understanding. I don't
15 know specifically which ones.

16 CHAIRMAN DUNN: And the process by which one, if
17 I am an owner of a generation unit here in California that's
18 under market-based rate authority, is, I have to apply for the
19 renewal of that authority.

20 MR. PEASE: That is my understanding, but I want
21 to put a small qualifier on that, because that's not an area
22 that I generally deal with.

23 CHAIRMAN DUNN: Maybe this might be outside the
24 area as well, Mr. Pease.

25 If I'm the hypothetical owner of a generation
26 unit, I'm applying for renewal of my ability to have
27 market-based rates, and I submit an application for renewal.

28 If no one submits any opposition to that

24

1 application, does FERC do an independent analysis or
2 investigation as to whether, in fact, that applicant for renewal
3 now has market power?

4 MR. PEASE: FERC has an obligation to make sure
5 that the rates that would be charged by that generator, be it
6 market-based rates, be it cost-based rates, be it whatever, are
7 just and reasonable.

8 So, the Commission would undertake whatever
9 investigation it felt was appropriate under the circumstances,
10 but it is the obligation of the Commission to make that
11 determination, even if there were no protests. I cannot imagine
12 that there would not be any protests.

13 CHAIRMAN DUNN: Won't argue that one.

14 Senator Bowen.

15 SENATOR BOWEN: One of the generators whose
16 license is up for renewal, not license, whose market-based rate
17 authority is up for renewal characterized the process as akin to
18 the renewal of a driver's license. In other words, basically
19 ministerial.

20 Would you concur with that?

21 MR. PEASE: As I said before, the situation in
22 California is unprecedented. And I think a level of review,
23 regardless of how one may have characterized it in the past, I
24 think the level of review, the scrutiny, may be increased, if
25 you will. This would be my personal opinion, not the
26 Commission's.

27 I think the official position would always be, we
28 give it appropriate scrutiny at all times. But we have to face
24

1 reality, things have changed. Whereas before, the Commission
2 was, and California, with the Legislature, legislation, was
3 engaging on, if you will, a grand experiment here, and --

4 SENATOR BOWEN: Now we have results.

5 MR. PEASE: And now we have results.

6 So, I don't think we're going to look at it the
7 same way, even if we have the same standards, and I'm not sure
8 that we even have the same standards in light of the various
9 orders that the Commission has issued in the past.

10 SENATOR BOWEN: So, you can reassure us that it
11 won't be a matter of pay your fee and get your rubber stamp.

12 MR. PEASE: I think that's fairly -- that's a
13 fairly safe --

14 SENATOR BOWEN: That's actually not evident to
15 many people in California.

16 MR. PEASE: I understand the frustration in
17 California with FERC. We've heard it quite often.

18 CHAIRMAN DUNN: And suspect it will continue for,
19 we won't even suggest how long.

20 I want to go back to the last sentence before
21 Senator Bowen posed her questions. You made mention that, when
22 I asked about whether FERC will do its own independent
23 investigation on those renewals, whether or not there's been any
24 opposition filed to those renewal applications. And you stated
25 that we, FERC, will look for unjust, unreasonable prices.

26 We might be skipping a step, if I understand your
27 answer, because unjust and unreasonable can be reached if, in
28 fact, for example, market power was actually exercised, giving
24

1 rise to prices that then FERC finds unjust and unreasonable.

2 It's my understanding, however, that to actually
3 have access to market-based rates, it's not the actual exercise
4 of market power that's the critical issue. It's whether you
5 have the potential to exercise market power.

6 MR. PEASE: That's correct.

7 CHAIRMAN DUNN: And if you do, you do not get
8 access to market-based rates.

9 Therefore, I'm going to go back to my question
10 again and say, if Acme Corporation applies for renewal for its
11 market-based rates here in California will FERC do its own
12 examination, whether opposition is filed or not, as to whether
13 in fact our hypothetical Acme Corporation actually has the
14 potential ability to exercise market power?

15 MR. PEASE: Yes.

16 CHAIRMAN DUNN: Okay.

17 Do you know which applications for renewals have
18 been filed yet?

19 MR. PEASE: No, I do not.

20 CHAIRMAN DUNN: Who would we go to within FERC to
21 determine that? I mean, I know the public filings are available
22 to the public, obviously, and we can determine that way.

23 But who heads up the handling of renewal
24 reapplications?

25 MR. PEASE: That's handled jointly by individuals
26 in the Office of Markets, Tariffs and Rates in the Office of
27 General Counsel, and our technical side, which is also called
28 Markets, Tariffs and Rates. Mr. Larkamp is the head of that

24

1 section.

2 I'm sure that if you made -- just asked us at the
3 Commission, we could provide that information for you.

4 CHAIRMAN DUNN: To wind it up, I'm going to go
5 back to an area we had talked about before that's related to
6 this.

7 It's my understanding that, at best, FERC's own
8 description of market power is uncertain.

9 MR. PEASE: I'm not sure exactly how to answer
10 that. I mean, that's a relatively loaded question, Senator.

11 CHAIRMAN DUNN: I'm shocked you would accuse me
12 of asking a loaded question.

13 MR. PEASE: The Commission has not specifically
14 defined, you know, what market power has meant -- means, that I
15 am aware of. We have articulated it, and certain Commissioners
16 have articulated it, and certain staff members have.

17 But as I said, I think there's general agreement
18 with the definition that we discussed earlier of the Department
19 of Justice. I may be mistaken, but I think we referred to that
20 in various orders.

21 CHAIRMAN DUNN: All right. So, fair to say, as

22 we did earlier, that the one definition we can agree on is that
23 provided by the Department of Justice?

24 MR. PEASE: I agree with you on that. As I said
25 a number of times, I'm not positive on what exactly the
26 Commission has said exactly on that subject.

27 CHAIRMAN DUNN: Senator Bowen, anything?

28 I think we've come to the end, Mr. Pease. Again,
24

1 my great gratitude on behalf of the entire committee for your
2 great patience today. We truly, truly appreciate it. It's well
3 beyond the hour we ever thought we would get to, but we
4 appreciate it.

5 We hope, as we go forward, we may have to reach
6 out again to FERC for witnesses to come and provide us
7 information such as you've done today. Sometimes not favorite
8 position to be in, I understand. But we greatly appreciate it.
9 It helps our understanding and furthers our investigation as we
10 go forward to also examine that wholesale electricity market.

11 Mr. Pease, thank you very much.

12 We are through for the day. Thank you, everyone.

13 [Thereupon this portion of the
14 Senate Select Committee hearing
15 was terminated at approximately.
16 5:55 P. M.]

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1 CERTIFICATE OF SHORTHAND REPORTER

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3 I, EVELYN J. MIZAK, a Shorthand Reporter of the State
4 of California, do hereby certify:

5 That I am a disinterested person herein; that the
6 foregoing transcript of the hearing of the Senate Select
7 Committee to Investigate Potential Manipulation in the Wholesale
8 Electricity Market, held in Irvine, California on Friday,
9 May 18, 2001, was reported verbatim in shorthand by me, Evelyn
10 J. Mizak, and thereafter transcribed into typewriting.

11 I further certify that I am not of counsel or
12 attorney for any of the parties to said hearing, nor in any way
13 interested in the outcome of said hearing.

14 IN WITNESS WHEREOF, I have hereunto set my hand this
15 _____ day of _____, 2001.

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EVELYN J. MIZAK
Shorthand Reporter

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